National Grid

Paige Graening
Counsel

July 26, 2004

Mary Cottrell, Secretary
Department of Telecommunications & Energy
One South Station, 2nd Floor
Boston, MA 02110

Re: Nantucket Electric Company/Massachusetts Electric Company -
Application for Authorization and Approval of Financing Proposals

Dear Secretary Cottrell:

Encloses for filing are one (1) original and six (6) hard copies of the following materials:

- Application of Nantucket Electric Company and Massachusetts Electric Company
- Exhibit NEC/MEC-1 – Direct Testimony of Robert G. Seega including his exhibits

The above materials are also being sent to you electronically.

Also included in this package is a check for $10,350.00 payable to the Commonwealth of Massachusetts to cover the required filing fee.

An additional copy of this filing letter is enclosed, to be date- and time-stamped and returned to me in the attached self-addressed, stamped envelope.

Please feel free to contact me should you have any questions regarding this filing.

Respectfully submitted,

Paige Graening (gke)

Paige Graening

Enclosures

cc: Joe Rogers

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THE COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Request for authorization and approval Under Sections 14 and 17A of Chapter 164 of the General Laws	)	D.T.E. 04-

APPEARANCE OF COUNSEL

In the above-entitled proceeding, the following attorneys appear for and on behalf of Nantucket Electric Company and Massachusetts Electric Company.

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James P. Meehan, Esq.

July 22, 2004

AFFIDAVIT OF ROBERT G. SEEGA

I, Robert G. Seega, state that:

1. I have prepared my direct testimony, submitted on behalf of Nantucket Electric Company and Massachusetts Electric Company, on July 26, 2004 in the proceeding to request for authorization and approval under Sections 14 and 17A of Chapter 164 of the General Laws.

2. I hereby swear that the information contained in my direct testimony is true, accurate and complete, to the best of my knowledge.

Robert G. Seega
Robert G. Seega
Assistant Treasurer
Nantucket Electric Company
Massachusetts Electric Company

Subscribed and sworn to under the pains and penalties of perjury this 26th day of July, 2004.

Gifty Bentum-Eshun
Notary Public

GIFTY A. BENTUM-ESHUN
Notary Public
Commonwealth of Massachusetts
My Commission Expires
May 17, 2007

THE COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

D.T.E. 04--

Application of Nantucket Electric Company and Massachusetts Electric Company:

Nantucket Electric Company requests authorization and approval under Section 14 of Chapter 164 of the General Laws of the following: (1) the execution of one or more loan agreements, supplemental loan agreements and/or notes with the Massachusetts Development Finance Agency and/or with direct or indirect parents of Nantucket Electric Company in connection with the issuance of new taxable or tax-exempt debt, or the refinancing of outstanding taxable or tax-exempt bonds, in an amount not to exceed $65 million in the aggregate outstanding at any one time, together with related financing and security agreements, and (2) exemption from the provisions of Section 15 and Section 15A of Chapter 164 of the General Laws, and an exemption from such obligations as the Department might otherwise prescribe under Section 16 of Chapter 164 of the General Laws.

Massachusetts Electric Company requests authorization and approval (1) under Section 17A of Chapter 164 of the General Laws to guarantee Nantucket Electric Company's obligation to pay principal, premium, if any, and interest on the long-term debt described in this Application, and (2) under Section 14 of Chapter 164 of the General Laws to issue additional first mortgage bonds to be pledged as credit support for the Nantucket Electric Company new debt described in this Application. Massachusetts Electric Company also requests exemption from the provisions of Section 15 and Section 15A of Chapter 164 of the General Laws.

To the Department of Telecommunications and Energy:

Nantucket Electric Company (hereinafter called "Nantucket") and Massachusetts Electric Company (hereinafter called "Mass. Electric") respectfully represent:

1. That Nantucket and Mass. Electric are Massachusetts corporations authorized to engage in and engaging in the business of distribution and sale of electricity at retail and that they are electric companies and distribution companies as defined in Chapter 164 of the General Laws of Massachusetts.

2. That the capitalization of Nantucket at March 31, 2004, was as follows:

Common equity	$24.0 million
Long-term debt	20.0 million
Long-term debt due within one year	1.5 million
Short-term debt to affiliates	2.5 million
Total capitalization	$48.0 million

All of the common stock is owned by National Grid USA, a wholly owned indirect subsidiary of National Grid Transco plc.

That the capitalization of Mass. Electric at March 31, 2004, was as follows:

Common equity	$1,649.0 million
Cumulative preferred stock	5.0 million
Long-term debt	213.0 million
Long-term debt due within one year	39.0 million
Short-term debt to affiliates	221.0 million
Total capitalization	$2,127.0 million

All of the common stock is owned by National Grid USA; Mass. Electric's first mortgage bonds, pollution control revenue refunding bonds and preferred stock are owned by non-affiliates.

3. That, as reflected in Nantucket's and Mass. Electric's filing with this Department in Docket MDTE 04-10, Nantucket is planning to install a second underground and submarine electric power cable from the Cape Cod mainland, across Nantucket Sound, to the Island of Nantucket (the "Second Nantucket Cable Project"). The first cable was installed in 1996 and leaves the Cape Cod mainland from the Town of Harwich (the "First Nantucket Cable Project"). The new cable system is planned to terminate on the mainland in the Hyannis section of the Town of Barnstable. This proposed Second Nantucket Cable Project is intended to provide Nantucket Island with a new connection to the New England electric grid in order to meet increasing load demands and to promote reliability in an economic and efficient manner of serving the public convenience and necessity.

4. That, on March 1, 1991, $3.5 million of tax-exempt electric utility revenue bonds, 8.5%, due March 1, 2016, were issued by the Massachusetts Industrial Finance Agency ("MIFA", predecessor to the Massachusetts Development Finance Agency or "MDFA") on behalf of

Nantucket, of which $2.775 million are currently outstanding (the “8.5% MDFA Bonds”), and that on July 1, 1996, $28 million of tax-exempt electric utility revenue bonds, having various fixed interest rates between 4.10% and 6.75%, due various dates through July 1, 2017, were issued by MIFA on behalf of Nantucket for purposes of financing Nantucket’s construction of the First Nantucket Cable Project, of which $17.5 million are currently outstanding (the “First Nantucket Cable MDFA Bonds”), collectively, the 8.5% MDFA Bonds and the First Nantucket Cable MDFA Bonds may be referred to as the “Existing MDFA Bonds”.

5. That Nantucket seeks to secure financing for the Second Nantucket Cable Project and for its other capital needs, and that current conditions in the capital markets also present an opportunity for Nantucket to refinance the Existing MDFA Bonds at significantly reduced interest costs. In order to take advantage of the opportunities presented by the current market, Nantucket proposes to secure such financing and to replace the Existing MDFA Bonds with one or more facilities, including multi-modal facilities, with maturities of up to 25 years.

6. That Nantucket seeks permission to execute one or more loan agreements, supplemental loan agreements, and/or notes in an amount not to exceed $65 million in the aggregate outstanding at any one time, such agreements or notes to be with the MDFA, a public agency empowered to issue debt, in connection with the issuance by MDFA of taxable or tax-exempt bonds, or with direct or indirect parents of Nantucket in connection with borrowings from such parents (“New Debt”). The proceeds of the New Debt will be used to finance the Second Nantucket Cable Project, to refinance outstanding debt of Nantucket, including, without limitation, the Existing MDFA Bonds, or to otherwise finance the capital needs of Nantucket. Permitting for the Second Nantucket Cable Project is well underway but is currently incomplete. Nantucket expects such permitting to be successfully finalized; however, in the event that the Second Nantucket

Cable Project is not actually approved for construction, Nantucket would limit the aggregate principal amount of New Debt to not exceeding $25 million outstanding at any one time. The initial issuance of the New Debt would occur on or before December 31, 2007.

7. That Nantucket desires to have the New Debt issued as tax-exempt debt through the MDFA, a public agency empowered to issue tax exempt or taxable debt. In order to issue an amount of tax-exempt New Debt, the MDFA will need to allocate an equivalent amount of volume cap to such issuance unless such issuance is for the purpose of refinancing Existing MDFA Bonds. Issuance of tax-exempt bonds by the MDFA to refinance Existing MDFA Bonds does not require allocation of volume cap.

8. That the recovery of the costs associated with financing the Second Nantucket Cable Project will be addressed in a separate cable facilities surcharge proceeding with the Department.

9. That Nantucket intends to seek as much volume cap as possible from the MDFA for purposes of financing the Second Nantucket Cable Project and other capital needs of Nantucket; however, Nantucket may not obtain sufficient volume cap initially for all of this New Debt to be issued through the MDFA as tax-exempt bonds. As mentioned above, refinancing of the Existing MDFA Bonds will not require allocation of volume cap and such refinancings will be undertaken on a tax exempt basis only. If sufficient volume cap is not obtained initially to the extent required, Nantucket proposes that the balance of New Debt incurred for purposes of financing the Second Nantucket Cable Project and other capital needs of Nantucket be issued through MDFA as taxable debt convertible to tax-exempt debt or be incurred through borrowings from direct or indirect parents of Nantucket. As volume cap is made available in subsequent years, Nantucket intends to refinance such debt as tax-exempt

New Debt in one or more refinancings (each, a "Tax-exempt Refinancing") to the extent feasible and economic. Any such Tax-exempt Refinancing would be subject to the same terms and requirements proposed in this Application for the initial issuance of New Debt and such refinanced debt would be regarded as "New Debt" for all purposes. Nantucket seeks approval to undertake such Tax-exempt Refinancings, and to execute one or more loan agreements or supplemental loan agreements with MDFA in connection therewith, through December 31, 2007; provided that, since Nantucket cannot predict when volume cap will become available, Nantucket may make a subsequent filing with the Department to seek an extension of such date.

10. That the New Debt characteristics will differ depending upon whether the New Debt is incurred through issuance of bonds by MDFA or through borrowings from direct or indirect parents of Nantucket.

11. That for New Debt issued through MDFA ("New MDFA Bonds"), such New MDFA Bonds will have the following characteristics:

(a) The New MDFA Bonds may bear interest in a daily, weekly, monthly, auction, commercial paper, term or semi-annual rate variable rate mode or in a fixed-rate mode (each a "Mode", and two or more collectively, "Modes") and will be structured to permit Nantucket, with the consent of MDFA, to convert bonds in a given Mode to bear interest at other Modes. The initial interest rate will be established by MDFA, Nantucket, and underwriters prior to the issuance or remarketing of the New MDFA Bonds. The various Modes establish different periods of time during which a particular interest rate would remain in effect. For example, in the case of the daily mode, the rate would be reset daily; in the weekly mode, the rate would be reset weekly. The actual rate for each period (other than auction Mode) would be set by remarketing agents based upon then prevailing market conditions. While in the auction Mode, the interest rate on the New MDFA Bonds will be established through the auction procedures set forth in the applicable indenture. In order to take further advantage of market conditions, Nantucket may structure the New MDFA Bonds into separate tranches or series, each with its own Mode and terms.

(b) The New MDFA Bonds may be secured by a bond insurance policy to be delivered at the time of issuance. When the New MDFA Bonds bear interest at a variable rate other than an auction rate, the owners of the New MDFA Bonds would have the right to tender the bonds for purchase upon specified notice periods. In order to assure the availability of funds to pay this purchase price (if, for some reason, the bonds could not be remarketed to new owners), the bonds may also be secured by liquidity support to be obtained at the time of conversion to such a Mode.

(c) The New MDFA Bonds may be subject to redemption at the option of Nantucket in accordance with the terms of the applicable indenture and otherwise as required by such indenture.

(d) Each issue of New MDFA Bonds will be sold at a price not less than 95% nor more than 100% of its principal amount. Tax-exempt New MDFA Bonds will bear interest at a rate not exceeding the then current rate for U. S. treasuries of similar maturity plus 150 basis points and taxable New MDFA Bonds will bear interest at a rate not exceeding the then current rate for U. S. treasuries of similar maturity plus 300 basis points (in each case, unless an order of the Department is issued approving a higher rate) and, provided, that, in the event that the tax-exempt New MDFA Bonds become taxable securities, the interest rate on the New MDFA Bonds will revert to a rate of interest not exceeding the then current rate for U. S. treasuries of similar maturity plus 300 basis points.

(e) The New MDFA Bonds will be sold by MDFA through one or more of (i) competitive bidding, (ii) negotiation with underwriters, (iii) negotiation directly with investors, (iv) through one or more agents, or (v) to one or more agents as principal for resale to investors, and will mature in not more than 25 years. Nantucket will not be a party to the agreements in connection with such issues but the agreements will provide that the terms of the New MDFA Bonds and their sale shall be satisfactory to Nantucket. Nantucket is requesting an exemption from the public auction provisions of Section 15 of Chapter 164 of the General Laws in order to permit flexibility in sale of the New MDFA Bonds. In addition, since underwriters may wish to receive their compensation as a discount from face value of the New MDFA Bonds, Nantucket is requesting an exemption from the provisions of Section 15A of Chapter 164 of the General Laws such that the New MDFA Bonds may be issued at less than par value.

12. That New Debt incurred through borrowings from direct or indirect parents of Nantucket will have the following characteristics:

(a) Each borrowing will be evidenced by a promissory note specifying the amount, maturity, interest rate, and other provisions for that borrowing.

(b) Each borrowing will have a maturity of greater than one year.

(c) Each borrowing will have either a fixed rate or adjustable rate to be determined using the following best rate method ("Best Rate Method"): the rate will be equal to the lowest of: National Grid Transco plc's cost of funds; the cost of funds incurred by an associate company in the National Grid USA system of companies; or the cost of funds available to Nantucket in a direct borrowing at that time from a non-associated, third party lender. Cost of funds shall be calculated taking into account projected expenses of issue expressed as a percentage of principal. This Best Rate Method calculation will be done based on debt of comparable terms and maturity. The interest rate on New Debt consisting of borrowings from direct or indirect parents of Nantucket shall in no event exceed the then current rate for U. S. treasuries of similar maturity plus 300 basis points.

(d) Each promissory note may be secured or unsecured depending on market conditions at the time of that borrowing. Each promissory note may include negative, affirmative, and financial covenants customarily included in such borrowings. Each promissory note will provide that it is a default to fail to make payment of any principal of, or premium on, a borrowing when due and payable. The occurrence of a payment default may give the direct or indirect parent lender a right to accelerate all payments under each promissory note. Each promissory note may include other default provisions customarily included in borrowings with non-associated, third party lenders.

13. That the New Debt may be supported by a letter or line of credit or standby bond purchase agreement with a bank or other financial entity, by bond insurance, or by such other credit or liquidity support ("Security") meeting, in the case of New MDFA Bonds, the requirements of the MDFA. Nantucket proposes to execute and deliver such agreements and documents as may be necessary to obtain such Security in connection with the New Debt, including, without limitation, insurance agreements and letter of credit and reimbursement agreements. Nantucket also proposes to execute and deliver other related financing and security agreements, as may be reasonably necessary in the view of Nantucket, to issue or refinance the New Debt.

14. That Mass. Electric seeks permission to issue and pledge, prior to December 31, 2007, one or more additional series and/or issues of its first mortgage bonds in an aggregate principal amount not exceeding $65 million ("New First Mortgage Bonds") outstanding at any one time having the following characteristics:

(a) The New First Mortgage Bonds may be pledged to secure Nantucket's obligations for payment of the principal of and premium, if any, and interest on the New MDFA Bonds. The New First Mortgage Bonds may be pledged to the trustee for the New MDFA Bonds, or to an insurer in connection with obtaining bond insurance for the New MDFA Bonds.

(b) Once the terms of the New MDFA Bonds are approved by the MDFA, the provisions of the New First Mortgage Bonds, if any, will generally parallel the provisions of the New MDFA Bonds with respect to which they are issued.

(c) That the New First Mortgage Bonds will be issued under and pursuant to the terms of a First Mortgage Indenture and Deed of Trust dated as of July 1, 1949, as amended and supplemented (the "First Mortgage Indenture"), securing Mass. Electric's first mortgage bonds.

(d) That the New First Mortgage Bonds may be issued in one or more series and/or issues, but no New First Mortgage Bonds shall mature more than 25 years from the date as of which they are issued and will be sold at a price not less than 95% nor more than 100% of their principal amount.

(e) That, although the maturity of the New First Mortgage Bonds may initially be parallel to the New MDFA Bonds, the New First Mortgage Bonds may or may not be callable, refundable, or puttable.

(f) That, if New First Mortgage Bonds are pledged in connection with New MDFA Bonds, an alternative form of collateral may be substituted for such New First Mortgage Bonds at a later date, subject to the approval of the entities to whom the subject New First Mortgage Bonds are pledged.

(g) That New First Mortgage Bonds will be pledged only if such pledge is necessary in connection with the issuance or refinancing of New MDFA Bonds.

15. That, in connection with each issue of New First Mortgage Bonds, Mass. Electric proposes to execute one or more indentures supplemental to the First Mortgage Indenture mortgaging or confirming the mortgage of the First Mortgage Indenture on all of its property, assets, and franchises (except property of the character excluded from the First Mortgage Indenture by its terms) as security for all first mortgage bonds issued, or to be issued, under and pursuant to the terms thereof.

16. That (a) Mass. Electric will receive no proceeds from the pledge of New First Mortgage Bonds and, consequently, the issue and pledge of these bonds will not affect the capitalization of Mass. Electric and (b) although these bonds will bear the same rate of interest as the corresponding issue of New MDFA Bonds, Mass. Electric will not have to pay interest on the New First Mortgage Bonds as long as interest payments are made on the New MDFA Bonds by Nantucket; and in no event would the total principal and interest paid to the holders of the New MDFA Bonds, or to the bond insurer, as the case may be, exceed the amounts provided for in bonds evidencing such New MDFA Bonds.

17. That, because the terms of any New First Mortgage Bonds would correspond to the terms of the related New MDFA Bonds, Mass. Electric is requesting an exemption from the competitive bidding and publication requirements of Section 15 of Chapter 164 of the General Laws with respect to the New First Mortgage Bonds.

18. That, in its Order dated October 10, 1995 (D.P.U. 95-67), the Department approved a guaranty by Mass. Electric of the First Nantucket Cable Project financing. Mass. Electric now seeks permission to guaranty Nantucket's payment of principal, premium, if any, and interest on the New MDFA Bonds in order to facilitate marketing of the subject debt to potential investors.

19. That Nantucket's total net utility plant at March 31, 2004 was only $35 million. The current estimated cost of the Second Nantucket Cable Project facilities is $37 million. Accordingly, Nantucket does not currently meet the net utility plant test for this financing; however, with the addition of $37 million to net utility plant and $35 million in debt to finance the Second Nantucket Cable Project, net utility plant will exceed total capitalization by approximately $6 million, excluding goodwill impacts. Nantucket is requesting an exemption from any obligation the Department might otherwise prescribe under Section 16 of Chapter 164 of the General Laws because, among other considerations, (i) Nantucket is wholly owned by National Grid USA and, thus, no member of the public owns any equity therein, and (ii) the anticipated completion of the Second Nantucket Cable Project facilities by the fourth quarter of 2005, along with Mass. Electric's role as guarantor, provide adequate assurance that Nantucket will promptly remedy any failure to meet the net utility plant test and any resultant impairment to its capital structure. This exemption request is similar to that approved by the Department for the First Nantucket Cable Project financing (See New England Electric System et. al., D.P.U. 95-67 (1995) at 14-15.)

WHEREFORE, Nantucket and Mass. Electric respectfully make application:

A. That the Department authorize, approve, and vote the execution and delivery of one or more loan agreements, supplemental loan agreements, and/or notes in an aggregate amount not exceeding $65 million outstanding at any one time, such agreements and notes to mature in not more than twenty-five (25) years and to be between Nantucket and the MDFA in connection with the issuance by the MDFA of taxable or tax-exempt bonds or refunding bonds, or between Nantucket and its direct or indirect parents in connection with borrowings from such parents, and that the Department authorize, approve, and vote the execution and delivery of one or more loan agreements or supplemental loan agreements between Nantucket and the MDFA for the purpose of refinancing some or all of such debt to the extent such debt is initially issued as taxable debt in connection with financing the Second Nantucket Cable Project or other capital needs of Nantucket; provided, that, in the event that the Second Nantucket Cable Project is not approved for construction, Nantucket shall limit the aggregate principal amount of such loan agreements or notes to not exceeding $25 million outstanding at any one time; and, provided, further, that (a) Nantucket shall use the proceeds of such loan agreements and notes to finance the Second Nantucket Cable Project or the other capital needs of Nantucket or to redeem and refinance the outstanding portion of the $3.5 million of tax exempt electric utility revenue bonds, 8.5%, due March 1, 2016, issued by the MIFA on behalf of Nantucket or the outstanding portion of the $28 million of tax exempt revenue bonds, currently having fixed interest rates ranging from 4.10% to 6.75%, due on various dates through July 1, 2017, issued by MIFA on behalf of Nantucket, (b) each issue of such debt be sold at a price not less than 95% nor more than 100% of its principal amount, exclusive of accrued interest and expenses, and (c) for tax-exempt debt, bear interest at a rate not exceeding the then current rate for U. S. treasuries of similar maturity plus 150 basis points and, for taxable debt and for direct or indirect parent borrowings, bear interest at a rate not exceeding the then current rate for U. S. treasuries of similar maturity plus 300 basis points; provided, that, in the event that such tax-exempt debt become taxable securities, the interest rate on such debt will revert to a rate of interest not exceeding the then current rate for U. S. treasuries of similar maturity plus 300 basis points (in each case, unless an order of the Department is issued approving a higher rate), and, for debt issued through the MDFA, be sold by the MDFA through one or more of (i) competitive bidding, (ii) negotiation with underwriters, (iii) negotiation directly with investors, (iv) through one or more agents, or (v) to one or more agents as principal for resale to investors.

B. That the Department authorize, approve, and vote that, to the extent a portion of such debt is initially issued as taxable debt or incurred through borrowings from Nantucket's direct or indirect parents, Nantucket may, from time to time in one or more transactions and as volume cap becomes available, refinance, through MDFA, some or all of such portion of taxable debt or such borrowings, in one or more series and/or issues, as tax-exempt bonds, to mature in not more than 25 years.

C. That the Department authorize, approve, and vote one or more additional issues of First Mortgage Bonds by Mass. Electric in a principal amount not exceeding $65 million in the aggregate outstanding at any one time, such First Mortgage Bonds to be issued if and to the extent necessary in order to secure bond insurance or other credit support for new debt referred to in paragraph A or B, above, issued as bonds through the MDFA, each such issue of said bonds to bear the same rate of interest as the corresponding issue of such new debt referred to in such paragraph A or B issued as bonds through the MDFA, to be secured, together with the then outstanding bonds, and any bonds hereafter issued, under Mass. Electric's First Mortgage Indenture, by a first mortgage of the franchises and property now owned or hereafter acquired by Mass. Electric (except property of the character specifically reserved as aforesaid), and to be pledged with a bond insurer for such new MDFA bonds or with the trustee under the applicable indenture for such new MDFA bonds as security for such bonds; and that the vote of the Department under Section 14 of Chapter 164 of the General Laws include authorization to issue such First Mortgage Bonds at below par value consistent with the corresponding new MDFA bonds.

D. That the Department authorize, approve, and vote the execution and delivery by Nantucket of such other financing and security agreements as may be reasonably necessary in the view of Nantucket in connection with the new debt described in this Application, including, without limitation, bond insurance agreements and letter of credit and reimbursement agreements.

E. That the Department authorize, approve, and vote Mass. Electric's guaranty of the payment of principal, premium, if any, and interest on such new debt.

F. That the Department authorize, approve, grant, and order an exemption from Section 15 of Chapter 164 of the General Laws such that Nantucket and Mass. Electric need not invite bids for the proposed transactions.

G. That the Department authorize, approve, grant, and order an exemption from Section 15A of Chapter 164 of the General Laws such that the new debt, and any Mass. Electric First Mortgage Bonds pledged in connection therewith, may be issued at less than par value.

H. That the Department authorize, approve, grant, and order an exemption from any obligation the Department might otherwise prescribe under Section 16 of Chapter 164 of the General Laws.

I. That the Department grant such other and further orders and approvals as the Department may deem proper in the circumstances.

Respectfully submitted,

NANTUCKET ELECTRIC COMPANY
MASSACHUSETTS ELECTRIC COMPANY

s/Robert G. Seega
By:_________________________________
Assistant Treasurer

Date: July 26, 2004

Exhibit NEC/MEC-1	Direct Testimony of Robert G. Seega, Assistant Treasurer, with the following attached exhibits:
Exhibit RGS-1	Savings Calculation for Refinanced Existing MDFA Bonds A. for the 8.5% MDFA Bonds B. for the First Nantucket Cable MDFA Bonds
Exhibit RGS-2	Current Tax Exempt Interest Rates
Exhibit RGS-3	Estimated Expenses of Issue
Exhibit RGS-4	Financial Exhibits A. for Nantucket Electric Company 1. 2004 Annual Report 2. Actual and Pro Forma Financial Statements B. for Massachusetts Electric Company C. Source and Application of Funds
Exhibit RGS-5	Comparison of Net Utility Plant to Total Capitalization

Counsel: Paige Graening, Esq.
James Meehan, Esq.

Nantucket Electric Company
Massachusetts Electric Company
25 Research Drive
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EXHIBIT NEC/MEC-1

Nantucket Electric Company
Massachusetts Electric Company

Direct Testimony of Robert G. Seega

July 26, 2004

Submitted to:
Massachusetts Department of
Telecommunications and Energy

Submitted by:

Nantucket Electric
A National Grid Company

Massachusetts Electric
A National Grid Company

DIRECT TESTIMONY OF ROBERT G. SEEGA

I. Introduction

Q. Please state your name and business address.

A. My name is Robert G. Seega. My business address is 25 Research Drive, Westborough, Massachusetts.

Q. By whom are you employed and in what capacity?

A. I am Assistant Treasurer of Massachusetts Electric Company ("Mass. Electric") and Nantucket Electric Company ("Nantucket") and Assistant Treasurer and Director of Treasury Services for National Grid USA Service Company, Inc. ("Service Company").

Q. Please describe your business background and education.

A. I have held a variety of Treasury positions at the Service Company including in the accounting, rates and investor relations departments. The Service Company provides these and other services at cost to Mass. Electric, Nantucket, and their affiliated companies at National Grid USA, formerly New England Electric System. I have a B. S. in business administration from Clark University, and my M.B.A. is from Nichols College.

Q. As Director of Treasury Services, what are your responsibilities?

A. I am responsible for providing certain financial services to all National Grid USA companies, including Nantucket and Mass. Electric. These financial services include assisting Nantucket in reviewing its capital structure and raising funds as necessary from third parties.

Q. Have you previously testified before regulatory agencies?

A. Yes. I have appeared before the Department, the Rhode Island Public Utilities Commission, the New York Public Service Commission, and the New York State Energy Research and Development Authority.

Q. Mr. Seega, would you please give a brief description of Nantucket and Mass. Electric?

A. Nantucket and Mass. Electric are Massachusetts corporations and are subsidiaries of National Grid USA, a Delaware corporation, and wholly owned indirect subsidiaries of National Grid Transco plc. The principal business of both companies is providing electric distribution service. Nantucket and Mass. Electric also serve as providers of Standard Offer Service and Default Service power supply for those customers that have not chosen to procure power from competitive power suppliers. Nantucket and Mass. Electric's retail electric rates are subject to the jurisdiction of the Department.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to support Nantucket's application to the Department for authorization and approval under Section 14 of Chapter 164 of the General Laws for the execution by Nantucket of one or more loan agreements, supplemental loan agreements and/or notes with the Massachusetts Development Finance Agency ("MDFA"), or with direct or indirect parents of Nantucket, in connection with the issuance of new taxable and/or tax-exempt debt, or the refinancing of outstanding debt, in an amount not to exceed $65 million, together with related financing and security agreements.

In addition, my testimony supports (i) Nantucket's and Mass. Electric's request for exemption from the provisions of Section 15 and Section 15A of Chapter 164 of the General Laws, (ii) Nantucket's request for an exemption from such obligations as the Department might otherwise prescribe under Section 16 of Chapter 164 of the General Laws, (iii) Mass. Electric's request for authorization under Section 17A of Chapter 164 of the General Laws to guarantee Nantucket's obligation to pay principal, premium, if any, and interest on the Nantucket new MDFA bonds, and (iv) Mass. Electric's request for authorization under Section 14 of Chapter 164 of the General Laws to issue additional first mortgage bonds to be pledged as credit support for the Nantucket new MDFA bonds.

II. The Proposed Financing

Q. Would you please explain why the financing is being proposed?

A. As indicated in the Application, the financing is principally aimed at enabling Nantucket to finance construction of a second underground and submarine cable for the distribution of electricity to its customers on the Island of Nantucket ("Second Nantucket Cable Project"). In addition, Nantucket plans to refund long-term debt previously issued through the Massachusetts Industrial Finance Agency ("MIFA"), predecessor to the MDFA, and to finance other capital needs of Nantucket.

Q. Please summarize the proposed financing.

A. Nantucket would enter into one or more loan agreements, supplemental loan agreements and/or notes, in an amount not to exceed $65 million in the aggregate outstanding at any one time, such agreements or notes to be with MDFA in connection with the issuance by MDFA of taxable and/or tax-exempt bonds or with direct or indirect parents of Nantucket in connection with borrowings from such parents ("New Debt"). Each new series and/or issue of New Debt will have various terms of maturity, but no New Debt shall mature more than 25 years from the date as of which it is issued. The proceeds from the issue and sale of the New Debt will be applied by Nantucket to the cost of, or the reimbursement of the treasury for, or the payment of short-term borrowings incurred for, retirement or refunding of outstanding debt of Nantucket, capitalizable additions and improvements to the plant and property of Nantucket, and other properly capitalizable expenditures. Nantucket intends to use the proceeds principally to finance Nantucket's construction of the Second Nantucket Cable Project and to refinance not exceeding $21 million of existing debt, including existing tax-exempt debt previously issued through MIFA on behalf of Nantucket.

Nantucket desires to have the New Debt issued as tax-exempt debt through the MDFA. In order to issue an amount of tax-exempt New Debt, the MDFA will need to allocate an equivalent amount of volume cap to such issuance unless such issuance is for the purpose of refinancing existing MDFA bonds. Issuance of tax-exempt bonds by the MDFA to refinance Existing MDFA Bonds does not require allocation of volume cap. Nantucket intends to seek as much volume cap as possible from the MDFA for purposes of financing the Second Nantucket Cable Project and other capital needs of Nantucket; however, Nantucket may not obtain sufficient volume cap initially for all of this New Debt to be issued through the MDFA as tax-exempt bonds. As mentioned above, refinancing of existing MDFA bonds will not require allocation of volume cap and such refinancings will be undertaken on a tax-exempt basis only. If sufficient volume cap is not obtained initially to the extent requested, Nantucket proposes that the balance of New Debt incurred for purposes of financing the Second Nantucket Cable Project and other capital needs of Nantucket be issued through MDFA as taxable debt convertible to tax-exempt debt or be incurred through borrowings from direct or indirect parents of Nantucket. As volume cap is made available in subsequent years, Nantucket will refinance such debt as tax-exempt New Debt through MDFA in one or more refinancings to the extent feasible and economic. Any such refinancings would be subject to the same terms and requirements proposed in the Application for the initial issuance of New Debt.

For New Debt incurred through issuance of bonds by MDFA ("New MDFA Bonds"), the New MDFA Bonds will be structured as multi-modal facilities and may bear interest in a daily, weekly, monthly, auction, commercial paper, term or semi-annual rate variable rate mode or in a fixed-rate mode (individually "Mode" and, collectively, "Modes") and will be structured to permit Nantucket, with the consent of MDFA, to convert bonds in a given Mode to bear interest at other Modes. In order to take further advantage of market conditions, Nantucket may structure the New MDFA Bonds into separate tranches or series each with its own Mode and terms. The initial interest rates will be established by MDFA, Nantucket, and underwriters prior to the issuance or remarketing of New MDFA Bonds. The various Modes establish different periods of time during which a particular interest rate would remain in effect. For example, in the case of the daily mode, the rate would be reset daily; in the weekly mode, the rate would be reset weekly. The actual rate for each period (other than auction rate Mode) would be set by remarketing agents based upon then prevailing market conditions. While in the auction rate Mode, the interest rate on New MDFA Bonds will be established through the auction procedures set forth in the applicable indenture. The New MDFA Bonds may be secured by a bond insurance policy to be delivered at the time of issuance, assuming this is determined to be cost-effective at the time the bonds are marketed. While bearing interest at a variable rate Mode other than an auction rate Mode, the owners of the New MDFA Bonds would have the right to tender the bonds for purchase upon specified notice periods. In order to assure the availability of funds to pay this purchase price (if, for some reason, such bonds could not be remarketed to new owners), such bonds may also be secured by liquidity support to be obtained at the time of conversion to such a Mode. The New MDFA Bonds will be subject to redemption at the option of Nantucket in accordance with the terms of the applicable loan agreement and otherwise as required by such agreement. It may be necessary for Mass. Electric to provide not exceeding $65 million of pledged first mortgage bonds as security for the New MDFA Bonds in order to secure bond insurance or other credit support for the New MDFA Bonds.

With respect to New Debt incurred through borrowings from direct or indirect parents of Nantucket, each borrowing will be evidenced by a promissory note specifying the amount, maturity, interest rate, and other provisions for that borrowing. Each borrowing will have a maturity of greater than one year and will have either a fixed rate or adjustable rate to be determined using the following best rate method ("Best Rate Method"): the rate will be equal to the lowest of: National Grid Transco plc's cost of funds; the cost of funds incurred by an associate company in the National Grid USA system of companies; or the cost of funds available to Nantucket in a direct borrowing at that time from a non-associated, third-party lender. Cost of funds shall be calculated taking into account projected expenses of issue expressed as a percentage of principal. This Best Rate Method calculation will be done based on debt of comparable terms and maturity. Each promissory note may (i) be secured or unsecured depending on market conditions at the time of that borrowing, (ii) include negative, affirmative, and financial covenants customarily included in such borrowings, (iii) provide that it is a default to fail to make payment of any principal of, or premium on, a borrowing when due and payable, (iv) provide that the occurrence of a payment default shall give the direct or indirect parent lender a right to accelerate all payments under each promissory note, and (v) include other default provisions customarily included in borrowings with non-associated, third party lenders.

Q. Please describe the Second Nantucket Cable Project.

A. Nantucket is planning to install a second underground and submarine electric power cable from the Cape Cod mainland, across Nantucket Sound, to the Island of Nantucket. The first cable was installed in 1996 and leaves the Cape Cod mainland from the Town of Harwich ("First Nantucket Cable Project"). The new cable system is planned to terminate on the mainland in the Hyannis section of the Town of Barnstable. This proposed Second Nantucket Cable Project is intended to provide Nantucket Island with a second connection to the New England transmission grid in order to provide more reliable service and to meet increased demand on Nantucket. The proposed project facilities will mirror the first cable installation. These facilities will include a new substation located in Barnstable, a 46 kilovolt, 35 megawatt underground and submarine electric power cable, a fiber optic communications cable, and a new 46 kilovolt circuit breaker, protective relays and ancillary electronic equipment located on the Island. A proposed submarine cable route from the Cape Cod landfall across Nantucket Sound has been chosen after extensive study to reduce or avoid impacts to cultural and natural resources, sensitive marine structures, and established navigation routes. The land-based portion of the cable is proposed to be installed underground within existing public rights-of-way (roadways) and selected privately-owned land. Nantucket plans to begin construction as soon as possible after all necessary permits have been received subject to seasonal construction moratoriums that may apply. The Second Nantucket Cable Project schedule presently calls for all permits to be issued by mid-December, 2004.

The Second Nantucket Cable Project will build on the success of the original 1996 cable installation. Nantucket believes that the result will provide Nantucket with an additional, reliable supply of electric power. It will supplement the capability to meet the Island's growing electric demand and further reduce the need for on-island generation to support contingency backup.

Q. How does Nantucket anticipate the costs of the Second Nantucket Cable Project would be recovered?

A. The cost associated with the first underground and submarine cable to the Island of Nantucket is currently recovered from Nantucket customers through a separate cable facilities surcharge ("CFS") mechanism approved by the Department in Docket No. D. P.U. 95-67. Nantucket anticipates that it will propose that the cost associated with the Second Nantucket Cable Project also be recovered from Nantucket's customers through a separate surcharge calculated in a manner similar to the existing CFS mechanism, as reflected in its Cable Facilties Surcharge Provision, M.D.T.E. No. 392.

Q. Please describe the existing MDFA Bonds that may be refinanced using New Debt.

A. The $3.5 million of tax-exempt electric utility revenue bonds, 8.5%, due March 1, 2016 were issued by MIFA, predecessor to MDFA, on behalf of Nantucket with proceeds to be used in connection with modernization, rehabilitation and replacement of Nantucket's existing electric distribution and load management systems, of which $2.775 million remain outstanding (the "8.5% MDFA Bonds"); MIFA also issued $28 million of tax-exempt bonds, having various fixed interest rates between 4.10% and 6.75% and due various dates through July 1, 2017, in connection with the financing of the First Nantucket Cable Project, of which $17.5 million remain outstanding (the "First Nantucket Cable MDFA Bonds"); the 8.5% MDFA Bonds and the First Nantucket Cable MDFA Bonds may be referred to, collectively, as the "Existing MDFA Bonds".

Q. Please describe the economics of refinancing the Existing MDFA Bonds.

A. Nantucket determines the economics of the refinancing by using the remaining term of the bonds to be refinanced. The 8.5% MDFA Bonds carry an interest rate of 8.5%, have a remaining term of twelve years, and are callable starting March 1, 2004, at a price of 100%. The First Nantucket Cable MDFA Bonds carry various fixed interest rates between 4.10% and 6.75%, have remaining terms between less than one year and thirteen years, and are callable starting on July 1, 2006 at a price of 102%. The call price reduces to 101% as of July 1, 2007. The matched fund rate of 4.74% is 255 basis points less than the level necessary to break-even on refinancing the 8.5% MDFA Bonds. Similarly, the matched fund rates of 4.21% and 4.30% for the First Nantucket Cable MDFA Bonds, depending upon the refinance date, is approximately 70 basis points less than the level necessary to break even.

Q. What would be the estimated savings from refinancing the Existing MDFA Bonds?

A. The estimated savings calculation is set forth in Exhibit RGS-1. Based on the matched fund rate of 4.74% derived from the schedule presented in Exhibit RGS-2, , the interest costs savings associated with the 8.5% MDFA Bonds would be approximately $100,000 annually and the net present value would be approximately $330,000. In the case of the First Nantucket Cable MDFA Bonds, the annual interest cost savings is approximately $205,000 to $235,000 and diminishes over time as a portion of these Bonds matures annually. The net present value would be approximately $210,000 to $240,000, depending on when the First Nantucket Cable MDFA Bonds are called. The combined annual estimated interest cost savings is approximately $305,000 to $335,000.

Q. What would be the interest rate on New Debt?

A. Exhibit RGS-2 sets forth current prevailing rates under different structures, for both short-term and long-term bonds. For New Debt incurred through borrowings from direct or indirect parents of Nantucket, the fixed rate or adjustable rate will be determined using the Best Rate Method described earlier.

Q. How will New MDFA Bonds be sold?

A. It is contemplated that the New MDFA Bonds would be sold by the MDFA through one or more of the following methods: (i) competitive bidding, (ii) negotiations with underwriters, (iii) negotiations directly with investors, (iv) through one or more agents, or (v) to one or more agents as principal for resale to investors. Nantucket will be a party to the bond purchase agreement(s), and, accordingly, the New MDFA Bonds and their sale shall be satisfactory to Nantucket. In addition, Nantucket expects to give certain written assurances to the underwriters or the institutional investors. Once the terms of the New MDFA Bonds are established, the provisions of Mass. Electric's corresponding Pledged Bonds (as described below), if any, would also be determined. The price of the New MDFA Bonds, exclusive of accrued interest and expenses, would not be less than 95% nor more than 100% of the principal amount.

Q. Why is it advantageous to have the authority to sell the New MDFA Bonds through negotiation with underwriters?

A. In my opinion, negotiated offerings can be more effective than competitive bidding for selling a large amount of bonds. Negotiated offerings allow pre-marketing to investors and would also enable Nantucket to respond more quickly to market changes because of the length of time involved in conducting a competitive bid issuance.

Q. What are Nantucket's current plans regarding the timing of these issues of New Debt?

A. The New Debt will be incurred on a periodic basis as the need for funds arises. Nantucket is requesting the authority to issue the New Debt from time to time through December 31, 2007. With respect to the Second Nantucket Cable Project, Nantucket would anticipate issuance of New Debt needed to finance that project upon commencement of construction, currently planned for late 2004. Nantucket is also seeking the authority to refinance as tax-exempt any portion of the New Debt initially issued as taxable debt or incurred through borrowings from direct or indirect parents of Nantucket. The timing of these refinancings will depend upon the allocation of volume cap by MDFA. Nantucket is proposing to undertake such refinancings, from time to time, on or before December 31, 2007; however, since Nantucket cannot predict when volume cap will become available, it may become necessary for Nantucket to make a subsequent filing with the Department requesting an extension of this date.

Q. What are you requesting for interest rate limits?

A. For tax-exempt New Debt, Nantucket is requesting the Department approve interest rates, that, at the time of any closing, do not exceed the then current rate for U.S. treasuries of similar maturity plus 150 basis points (unless an order of the Department is issued approving a higher rate); provided, that, in the event that New Debt is issued as, or become, taxable securities, or is incurred through borrowings from direct or indirect parents of Nantucket, the interest rate on such New Debt will be a rate of interest not exceeding the then current rate for U.S. treasuries of similar maturity plus 300 basis points. These interest rate limits will provide Nantucket with flexibility to refinance the New Debt during its term in the event that market conditions should change.

Q. What are the estimated expenses of issuing the New Debt?

A. Exhibit RGS-3 contains our current estimate for expenses of issuing the New Debt.

Q. Would you please describe the structure of the New MDFA Bonds?

A. Pursuant to the MDFA enabling legislation, MDFA may issue bonds to finance and to refinance certain activities by private corporations. Typically, MDFA and the corporation will enter into a loan agreement. Under these agreements, MDFA will agree to issue bonds to the public and lend the proceeds from the sale thereof to the corporation in exchange for the corporation's promise to make payments to the agency sufficient to pay the principal of and premium, if any, and interest on the bonds. The bonds sold to the public clearly state that they are only payable from revenues paid by the corporation; therefore, the interest rate these bonds carry varies with the creditworthiness of the corporation on whose behalf the bonds are being issued. If certain provisions of the federal tax laws are met, the interest payments received by holders of these bonds will be excludable from gross income for federal and Massachusetts income tax purposes. Because of this, the holders will accept a lower interest rate than they would if the interest payments were fully taxable. In today's market, long-term, tax-exempt debt is issued with interest rates that are approximately 20% lower than interest rates on comparable taxable debt. As mentioned earlier, in order to issue an amount of tax-exempt debt, the MDFA will need to allocate an equivalent amount of volume cap to such issuance unless such issuance is for the purpose of refinancing existing MDFA bonds.

Once tax-exempt bonds have been issued on behalf of a corporation, they may be refunded, in accordance with their terms and subject to the approving tax opinion of bond counsel, and retain their tax-exempt status. The continued ownership of the facilities originally financed by the debt is not a requirement in order to refinance the tax-exempt bonds. The refunding tax-exempt bonds may have a maturity longer than the remaining term of the outstanding tax-exempt bonds, subject to certain requirements established under federal tax law concerning the expected life of the subject facilities.

Q. If variable rate New MDFA Bonds are issued, how often would the interest rate be reset on the variable rate New MDFA Bonds, and how would the new rate be determined?

A. The reset could be as often as every day or only once every six months, or even less frequently. The term would be determined by Nantucket based on current market conditions. Except for bonds in the auction mode, at the time of each reset, bondholders would have the right to 'put' their bonds at their face value plus accrued interest. In such cases, a remarketing agent, retained by Nantucket, would set the new rate at the lowest rate of interest that would, in its judgment, having due regard for prevailing market conditions, allow the bonds to be remarketed at their par value.

Q. When will Nantucket refinance the Existing MDFA Bonds?

A. The 8.5% MDFA Bonds became callable March 1, 2004 at par. The First Nantucket Cable MDFA Bonds will be callable July 1, 2006. Under current IRS rules, tax-exempt bonds issued for the purpose of refunding outstanding tax-exempt private activity bonds may be issued no earlier than ninety days prior to the date on which the outstanding bonds are called. If such bonds were to be issued within this ninety-day window, Nantucket would invest the proceeds in obligations issued or guaranteed by the United States government. However, Nantucket may agree upon the terms of a sale of the New Debt prior to the ninety-day IRS window but delay closing until the ninety-day window has commenced (delayed settlements). These delayed settlement transactions would lock in favorable interest rates before actually issuing such New Debt. Delayed settlement transactions typically are executed at a premium over current spot new issue rates for such bonds.

Q. Why would a guarantee by Mass. Electric of the financing be desirable?

A. Mass. Electric has a strong credit rating, whereas Nantucket does not have a credit rating. A direct Mass. Electric guarantee simplifies the marketing of the financing to potental purchasers but does not impose any significant additional risk on Mass. Electric.

Q. Please explain “pledged bonds”?

A. The pledged bonds are Mass. Electric First Mortgage Bonds that may be pledged to the trustee for the New MDFA Bonds, or to a bond insurer for the New MDFA Bonds, as additional security representing a first mortgage claim for the holders of all New MDFA Bonds ("Pledged Bonds"). Mass. Electric First Mortgage Bonds will be pledged only if such pledge is necessary in connection with the issuance or refinancing of New MDFA Bonds.

Q. What advantage does the existence of Pledged Bonds provide the bondholders or the bond insurer?

A. In the event of a default by Nantucket giving rise to a failure to pay principal or interest on the New MDFA Bonds, the Pledged Bonds give the holder a first mortgage lien on substantially all of the property of Mass. Electric along with the holders of other outstanding first mortgage bonds of Mass. Electric.

Q. Please describe the terms of the Pledged Bonds?

A. Mass. Electric seeks permission to issue and pledge, prior to December 31, 2007, one or more additional series and/or issues of its first mortgage bonds in an aggregate principal amount not exceeding $65 million ("New First Mortgage Bonds") having the following characteristics:

(a) The New First Mortgage Bonds may be pledged to secure Nantucket's obligations for payment of the principal of and premium, if any, and interest on the New MDFA Bonds. The New First Mortgage Bonds may be pledged to the trustee for New MDFA Bonds, or to an insurer in connection with obtaining bond insurance for New MDFA Bonds.

(b) Once the terms of New MDFA Bonds are approved by the MDFA, the provisions of related New First Mortgage Bonds, if any, will generally parallel the provisions of the

New MDFA Bonds with respect to which they are issued.

(c) The New First Mortgage Bonds will be issued under and pursuant to the terms of a First Mortgage Indenture and Deed of Trust dated as of July 1, 1949, as amended and supplemented (the "First Mortgage Indenture"), securing Mass. Electric's first mortgage bonds.

(d) The New First Mortgage Bonds will be issued in one or more series and/or issues, but no New First Mortgage Bonds shall mature more than 25 years from the date as of which they are issued. The New First Mortgage Bonds will be sold at a price not less than 95% nor more than 100% of their principal amount.

(e) The New First Mortgage Bonds may or may not be callable, refundable, or puttable.

(f) If New First Mortgage Bonds are pledged in connection with New MDFA Bonds, an alternative form of collateral may be substituted for such New First Mortgage Bonds at a later date, subject to the approval of the entities to whom the subject New First Mortgage Bonds are pledged. In connection with each issue of New First Mortgage Bonds, Mass. Electric proposes to execute one or more indentures supplemental to the First Mortgage Indenture mortgaging or confirming the mortgage of the First Mortgage Indenture on all of its property, assets, and franchises (except property of the character excluded from the First Mortgage Indenture by its terms) as security for all first mortgage bonds issued, or to be issued, under and pursuant to the terms thereof.

Mass. Electric will receive no proceeds from the pledge of New First Mortgage Bonds and, consequently, the issue and pledge of these bonds will not affect the capitalization of Mass. Electric. Although the New First Mortgage Bonds will bear the same rate of interest as the corresponding issue of New MDFA Bonds, Mass. Electric will not have to pay interest on the New First Mortgage Bonds as long as interest payments are made on the New MDFA Bonds by Nantucket; and in no event would the total principal and interest paid to the holders of the New MDFA Bonds, or to the bond insurer, as the case may be, exceed the amounts provided for in such New MDFA Bonds.

Q. Will the terms of the New First Mortgage Bonds be parallel to the terms of the New MDFA Bonds?

A. Yes. Generally, New First Mortgage Bonds would parallel the provisions of the New MDFA Bonds with respect to which they are issued. Interest on the New First Mortgage Bonds would not be required to be paid so long as interest payments are made on the New MDFA Bonds by Nantucket. If there were a default under the loan and trust agreement for the New MDFA Bonds, interest and principal due on the New First Mortgage Bonds would be paid to the trustee for the New MDFA Bonds, or to the bond insurer, as the case may be; however, in no event would the total principal and interest paid to the holders of the New MDFA Bonds, or such bond insurer, exceed the amounts provided for in the New MDFA Bonds. Although the maturity of the New First Mortgage Bonds may initially be parallel to the New MDFA Bonds, the New First Mortgage Bonds may be callable, refundable, or puttable.

III. <u>Present Capitalization.</u>

Q. Will you please state the present capitalization of Nantucket and Mass. Electric and indicate the ownership of their outstanding securities?

A. Exhibit RGS-4 contains Nantucket’s and Mass. Electric’s Financial Statements. Nantucket's capital structure is shown on page 3 of Exhibit RGS-4(A)-1. At March 31, 2004, there was one common share outstanding having a par value of $1 per share or an aggregate par value of $1. There was no premium paid on capital stock. Other paid-in capital, representing additional investments in the form of capital contributions from National Grid USA, amounted to $22,481,000. Retained earnings and unappropriated, undistributed subsidiary earnings were approximately $2,535,000. Accumulated other comprehensive income (loss) was approximately ($1,158,000). Nantucket's total common equity was approximately $23,858,000. There were no outstanding shares of cumulative preferred stock.

As shown under the heading "Long-Term Debt", at March 31, 2004, Nantucket had approximately $20,055,000 of long-term debt outstanding (net of unamortized premium and discount). The interest rates ranged from 5.30% to 8.50% and the maturities from July 1, 2004 to July 1, 2017.

At March 31, 2004 Nantucket had $2,550,000 of short-term, unsecured indebtedness outstanding and $1,535,000 of long-term debt due within one year.

Nantucket's total capitalization at March 31, 2004 was approximately $43,913,000. Nantucket's capital structure consisted of 54% common equity, and 46% bonds. All of Nantucket's common stock is owned by National Grid USA.

Mass. Electric's capital structure is shown on page 3 of Exhibit RGS-4(B). At March 31, 2004, there were 2,398,111 common shares outstanding having a par value of $25 per share or an aggregate par value of approximately $59,953,000. Other paid-in capital, representing additional investments in the form of capital contributions from National Grid USA, amounted to $1,508,991,000. Retained earnings and unappropriated, undistributed subsidiary earnings were approximately $203,729,000. Accumulated other comprehensive income (loss) was approximately ($123,665,000).

Mass. Electric's total common equity was approximately $1,649,008,000.

There were also outstanding 47,265 shares of cumulative preferred stock with an aggregate book value of approximately $4,727,000.

As shown under the heading "Long-Term Debt", at March 31, 2004, Mass. Electric had approximately $213,209,000 of long-term debt outstanding (net of unamortized premium and discount). Long-term debt consisted of 22 issues of First Mortgage Bonds and one issue of Pollution Control Revenue Refunding bonds. The interest rates ranged from 5.72% to 8.85% and the maturities from 2004 to 2028.

At March 31, 2004 Mass. Electric had $220,575,000 of short-term, unsecured indebtedness outstanding, and $39,000,000 of long-term debt due within one year.

Mass. Electric's total capitalization at March 31, 2004 was approximately $1,866,944,000. Mass. Electric’s capital structure consisted of 88.3% common equity, 0.3% preferred stock, and 11.4% bonds. All of Mass. Electric’s common stock is owned by National Grid USA; all of the preferred stock, First Mortgage Bonds and Pollution Control Revenue Refunding bonds are owned by the public.

Q. Please explain Nantucket’s balance sheet as of March 31, 2004.

A. Nantucket’s Utility Plant is shown on page 3 of Exhibit RGS-4(A)-1 to be, in round numbers, $50 million. Construction work in progress is shown to be $3 million. The accumulated provision for depreciation is $18 million, and the net utility plant is about $35 million. Other property and investments at that date totaled approximately $24 million, including $15.7 million of good will, net of amortization. The total assets and other debits of Nantucket amounted to $59 million.

Q. Would you briefly describe Pages 1 through 3 of Exhibit RGS-4(A)-2?

A. Pages 1 through 3 of Exhibit RGS-4(A)-2 consist of actual and pro forma balance sheets at March 31, 2004, and related statements of income for the 12-month period ended March 31, 2004. Page 3 explains the pro forma impact of the proposed financing. Exhibit RGS-4(C) contains an actual source and application of funds statement for fiscal year ended March 31, 2004 and estimated statements for fiscal years 2005 through 2008.

Q. Why are you requesting the Department not issue special conditions and requirements such at it might otherwise prescribe under Section 16 of Chapter 164?

A. Exhibit RGS-5 describes Nantucket's net utility plant and total capitilization as of March 31, 2004. Nantucket's total net utility plant at March 31, 2004 was only $35 million. The current estimated cost of the Second Nantucket Cable Project facilities is $37 million. Accordingly, Nantucket does not currently meet the net utility plant test for the proposed financing; however, with the addition of $37 million to net utility plant and $35 million in debt to finance the Second Nantucket Cable Project, net utility plant will exceed total capitalization by approximately $6 million, excluding goodwill impacts. To the extent there is an impairment of the capital stock of Nantucket as a result of not currently meeting the net utility plant test, we request that no special conditions be imposed since (a) Nantucket's stock is held by National Grid USA and not by the general investing public the test was designed to protect, and (b) the Mass. Electric guaranty, and the anticipated completion of the Second Nantucket Cable Project facilities in the fourth quarter of 2005, provide adequate assurance that Nantucket will promptly remedy any failure to meet the net utility plant test and any resultant impairment to its capital structure.

IV. Requests for Exemption

Q. Why are Nantucket and Mass. Electric asking for exemption from Section 15 of Chapter 164 of the General Laws?

A. As I mentioned earlier, the MDFA may take advantage of one or more methods of selling the New MDFA Bonds. Although Nantucket may request that the MDFA sell the New MDFA Bonds at competitive bidding, Nantucket wants to be able to respond more quickly to market changes, which is essential to the facilitation and effectiveness of negotiated offerings. In order to facilitate such alternative procedures or should Nantucket elect to negotiate the terms of the bonds, Nantucket requests an exemption from the competitive bidding requirements of Section 15 of Chapter 164 of the General Laws. This flexibility will permit Nantucket to obtain favorable interest rates for this refinancing.

In addition, because the terms of any New First Mortgage Bonds would generally correspond to the terms of the New MDFA Bonds, Mass. Electric is requesting an exemption from the competitive bidding and publication requirements of Section 15 of Chapter 164 of the General Laws with respect to the New First Mortgage Bonds.

Q. Why are Nantucket and Mass. Electric asking for exemption from Section 15A of Chapter 164 of the General Laws?

A. Underwriters may desire to receive their compensation in the form of a discount from face value of the New MDFA Bonds. The ability to issue New MDFA Bonds and corresponding pledged New First Mortgage Bonds, if any, at a price not less than 95% nor more than 100% of their principal amount may enhance the marketability of the New MDFA Bonds and favorably affect the cost of borrowing.

Q. Is the issuance of the New Debt subject to approval by any regulatory agency other than this Department?

A. Other than authorization from the MDFA and approval from the Governor pursuant to the Tax Equity and Fiscal Responsibility Act of 1982 (“TEFRA”), there are no other regulatory approvals required.

Q. In your opinion, will the issuance of the New Debt be in the public interest?

A. Yes.

V. Conclusion

Q. Does this complete your direct testimony?

A. Yes, it does.

Exhibit RGS-1(A)

Nantucket Electric Company
Refinancing 1991 Series MIFA Issue, Electric Utility Revenue Bonds
$2,775,000

	Expenses Under Existing Issue			Expenses with a New Issue				
Year Ended March 1:	Interest 8.500%	Fees	Total	Interest (1) Matched Fund 4.74%	Fees(2)	Net Taxes (3)	Total	Annual Savings
2005	58,969 (4)	0	58,969	32,884	152,069	9,960	194,912	(135,943)
2006	235,875	0	235,875	131,535	2,775	39,839	174,149	61,726
2007	235,875	0	235,875	131,535	2,775	39,839	174,149	61,726
2008	235,875	0	235,875	131,535	2,775	39,839	174,149	61,726
2009	235,875	0	235,875	131,535	2,775	39,839	174,149	61,726
2010	235,875	0	235,875	131,535	2,775	39,839	174,149	61,726
2011	235,875	0	235,875	131,535	2,775	39,839	174,149	61,726
2012	235,875	0	235,875	131,535	2,775	39,839	174,149	61,726
2013	235,875	0	235,875	131,535	2,775	39,839	174,149	61,726
2014	235,875	0	235,875	131,535	2,775	39,839	174,149	61,726
2015	235,875	0	235,875	131,535	2,775	39,839	174,149	61,726
2016	235,875	0	235,875	131,535	2,775	39,839	174,149	61,726
Total	$2,653,594		$2,653,594	$1,479,769	$182,594	$448,187	$2,110,550	$543,044
NPV @	6.00%		$1,810,647				$1,479,625	$331,021

(1) Interest rate for new tax exempt date based on unsecured A2/A credit rating.

(2) Upfront expenses:

Redemption premium	0		redeemable at par as of 3-1-04
Underwriters' fees	75,000		
MDFA fee	13,875	@	0.50% of principal
Attorney fees	37,500		
Trustee fees	25,000		
Estimated Upfront Expenses	151,375		
Ongoing annual fees	2,775	@	0.10% of principal
	154,150		

(3) Effective tax rate: 39.23%

(4) Assumed refinance date: 12/01/2004 25% of financing year

Nantucket Electric Company
Refinancing 1996 Series MIFA Issue, Electric Utility Revenue Bonds
$14,700,000

	Expenses Under Existing Issue			Expenses with a New Issue				
Year Ended June 30: (1)	Interest	Fees	Total	Interest (2) Matched Fund 4.21%	Fees(3)	Net Taxes (4)	Total	Annual Savings
2005		0	0		0	0	0	0
2006		0	0		0	0	0	0
2007	856,275	0	856,275	618,870	637,750	(157,035)	1,099,585	(243,310)
2008	777,875	0	777,875	559,930	13,300	80,272	653,502	124,373
2009	697,375	0	697,375	500,990	11,900	72,364	585,254	112,121
2010	616,875	0	616,875	442,050	10,500	64,456	517,006	99,869
2011	534,625	0	534,625	383,110	9,100	55,862	448,072	86,553
2012	452,375	0	452,375	324,170	7,700	47,268	379,138	73,237
2013	370,125	0	370,125	265,230	6,300	38,674	310,204	59,921
2014	287,875	0	287,875	206,290	4,900	30,080	241,270	46,605
2015	205,625	0	205,625	147,350	3,500	21,485	172,335	33,290
2016	123,375	0	123,375	88,410	2,100	12,891	103,401	19,974
2017	41,125	0	41,125	29,470	700	4,297	34,467	6,658
Total			$4,963,525			$270,615	$4,544,235	$419,290
NPV @	6.00%		$3,499,208				$3,255,206	$244,002

(1) Refinance in year ending June 30, 2007

(2) Interest rate for new tax exempt date based on unsecured A2/A credit rating.

(3) Upfront expenses:

Redemption premium	294,000	@	2.00%	of principal
Underwriters' fees	110,250	@	0.75%	of principal
MDFA fee	73,500	@	0.50%	of principal
Attorney fees	75,000			
Rating Agencies	50,000			
Trustee fees	25,000			
Printing	10,000			
Estimated Upfront Expenses	637,750			
Ongoing annual fees	14,700	@	0.10%	of principal
	652,450			

(4) Effective tax rate: 39.23%

Nantucket Electric Company
Refinancing 1996 Series MIFA Issue, Electric Utility Revenue Bonds
$13,300,000

	Expenses Under Existing Issue			Expenses with a New Issue				
Year Ended June 30: (1)	Interest	Fees	Total	Interest (2) Matched Fund 4.30%	Fees (3)	Net Taxes (4)	Total	Annual Savings
2005		0	0		0	0	0	0
2006		0	0		0	0	0	0
2007	0	0	0	0	0	0	0	0
2008	777,875	0	777,875	571,509	459,250	(99,194)	931,565	(153,690)
2009	697,375	0	697,375	511,350	11,900	68,301	591,551	105,824
2010	616,875	0	616,875	451,191	10,500	60,871	522,562	94,313
2011	534,625	0	534,625	391,032	9,100	52,755	452,887	81,738
2012	452,375	0	452,375	330,874	7,700	44,639	383,212	69,163
2013	370,125	0	370,125	270,715	6,300	36,523	313,537	56,588
2014	287,875	0	287,875	210,556	4,900	28,406	243,862	44,013
2015	205,625	0	205,625	150,397	3,500	20,290	174,187	31,438
2016	123,375	0	123,375	90,238	2,100	12,174	104,512	18,863
2017	41,125	0	41,125	30,079	700	4,058	34,837	6,288
Total			$3,449,250			$228,822	$3,195,314	$253,936
NPV @	6.00%		$2,430,600				$2,571,727	$208,536

(1) Refinance in year ending June 30, 2008

(2) Interest rate for new tax exempt date based on unsecured A2/A credit rating.

(3) Upfront expenses:

Redemption premium	133,000	@	1.00%	of principal
Underwriters' fees	99,750	@	0.75%	of principal
MDFA fee	66,500	@	0.50%	of principal
Attorney fees	75,000			
Rating Agencies	50,000			
Trustee fees	25,000			
Printing	10,000			
Estimated Upfront Expenses	459,250			
Ongoing annual fees	13,300	@	0.10%	of principal
	472,550			

(4) Effective tax rate: 39.23%

Exhibit RGS-2

Nantucket Electric Company
Current Tax Exempt Interest Rates

	MMD High Grade (%)	Insured (%)	Unsecured Nantucket Electric A2/A (%)
2005	1.50	1.95	2.30
2006	1.94	2.39	2.74
2007	2.34	2.79	3.14
2008	2.67	3.12	3.47
2009	2.91	3.36	3.71
2010	3.12	3.52	3.87
2011	3.31	3.71	4.06
2012	3.47	3.87	4.22
2013	3.63	4.03	4.38
2014	3.75	4.15	4.50
2015	3.88	4.28	4.63
2016	3.99	4.39	4.74
2017	4.08	4.48	4.83
2018	4.16	4.56	4.91
2019	4.24	4.64	4.99
2020	4.32	4.72	5.07
2021	4.40	4.80	5.15
2022	4.48	4.88	5.23
2023	4.56	4.96	5.31
2024	4.64	5.04	5.39
2025	4.73	5.13	5.48
2026	4.80	5.20	5.55
2027	4.84	5.24	5.59
2028	4.86	5.26	5.61
2029	4.87	5.27	5.62
2030	4.88	5.28	5.63
2031	4.89	5.29	5.64
2032	4.90	5.30	5.65
2033	4.90	5.30	5.65
2034	4.90	5.30	5.65

NANTUCKET ELECTRIC COMPANY
Estimated Expenses of Issue
(In Millions)

MassDevelopment Finance Agency Fee	$	750,000
Underwriting Fee		300,000
Attorney's Fees & Expenses		100,000
Rating Agencies' Fees		75,000
Trustee Fees & Expenses		50,000
Printing		10,000
Total Estimated Expenses of Issue	$	1,285,000

Annual Report 2004

Nantucket Electric

A National Grid Company

Nantucket Electric Company

Report of Independent Auditors

To the Stockholder and Board of Directors of
Nantucket Electric Company, Westborough, Massachusetts:

In our opinion, the accompanying balance sheets and the related statements of income, of comprehensive income, of retained earnings and of cash flows present fairly, in all material respects, the financial position of Nantucket Electric Company, a wholly owned subsidiary of National Grid USA, at March 31, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP
PricewaterhouseCoopers LLP

Boston, Massachusetts
May 6, 2004

Nantucket Electric Company

Statements of Income

Year ended March 31 (In thousands)	2004	2003
Operating revenue	**$19,765**	$17,929
Operating expenses:		
Purchased electric energy:		
Non-affiliates	**8,666**	6,540
Contract termination charges from New England Power Company, an affiliate	**1,019**	1,029
Other operation	**3,657**	3,691
Maintenance	**589**	513
Depreciation and amortization	**2,484**	2,419
Taxes, other than income taxes (Note H)	**427**	440
Income taxes (Note E)	**538**	873
Total operating expenses	**17,380**	15,505
Operating income	**2,385**	2,424
Other income:		
Other income, net	**46**	50
Operating and other income	**2,431**	2,474
Interest:		
Interest on long-term debt	**1,449**	1,530
Other interest	**91**	95
Allowance for borrowed funds used during construction	**(20)**	(23)
Total interest	**1,520**	1,602
Net income	**$ 911**	$ 872

Statements of Comprehensive Income

Year ended March 31 (In thousands)	2004	2003
Net income	**$ 911**	$ 872
Other comprehensive income (loss):		
Unrealized gains (losses) on securities, net of taxes of $16 and ($11), respectively	**30**	(20)
Change in additional minimum pension liability, net of taxes of ($441) and ($30), respectively	**(762)**	(399)
Comprehensive income	**$ 179**	$ 453

Statements of Retained Earnings

Year ended March 31 (In thousands)	2004	2003
Retained earnings at beginning of year	**$ 1,624**	$ 752
Net income	**911**	872
Retained earnings at end of year	**$ 2,535**	$ 1,624

The accompanying notes are an integral part of these financial statements.

Nantucket Electric Company

Balance Sheets

At March 31 (In thousands)	2004	2003
Assets		
Utility plant, at original cost	**$ 49,989**	$ 48,876
Less accumulated provisions for depreciation	**(17,812)**	(15,740)
	32,177	33,136
Construction work in progress, net of customer contribution	**3,002**	1,591
Net utility plant	**35,179**	34,727
Goodwill	**15,679**	15,679
Pension intangible	**50**	-
Current assets:		
Cash and cash equivalents	**412**	178
Accounts receivable:		
From electric energy services, including unbilled revenues (Note A-3)	**4,427**	4,044
Other (including $1,121 and $684 from affiliates)	**1,126**	724
Less reserves for doubtful accounts	**(29)**	(39)
Total accounts receivable	**5,524**	4,729
Materials and supplies, at average cost	**192**	196
Prepaid and other current assets	**7**	4
Total current assets	**6,135**	5,107
Deferred charges and other assets (Note B)	**2,143**	2,450
Total assets	**$ 59,186**	$ 57,963
Capitalization and Liabilities		
Capitalization:		
Common stock, par value $1 per share		
Authorized - 1,200 shares		
Outstanding - 1 share	**$ -**	$ -
Other paid-in capital	**22,481**	22,481
Retained earnings	**2,535**	1,624
Accumulated other comprehensive loss	**(1,158)**	(426)
Total common equity	**23,858**	23,679
Long-term debt (Note G)	**20,055**	21,704
Total capitalization	**43,913**	45,383
Current liabilities:		
Long-term debt due within one year (Note G)	**1,535**	1,400
Short-term debt to affiliates (Note F)	**2,550**	825
Accounts payable (including $104 and $677 to affiliates)	**1,620**	2,038
Accrued liabilities:		
Taxes	**249**	477
Deferred federal and state income taxes (Note E)	**86**	207
Interest	**309**	317
Other accrued expenses (Note F)	**3,213**	2,341
Customer deposits	**22**	23
Total current liabilities	**9,584**	7,628
Deferred federal and state income taxes (Note E)	**2,513**	2,412
Unamortized investment tax credits	**63**	78
Accrued pension and other post-retirement benefits	**1,211**	1,052
Additional minimum pension liability	**1,233**	74
Other reserves and deferred credits	**669**	1,336
Commitments and contingencies (Note C)		
Total capitalization and liabilities	**$ 59,186**	$ 57,963

The accompanying notes are an integral part of these financial statements.

Nantucket Electric Company

Statements of Cash Flows

Year ended March 31 (In thousands)	2004	2003
Operating activities:		
Net income	**$ 911**	$ 872
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**2,484**	2,419
Deferred income taxes and investment tax credits, net	**381**	447
Changes in current operating assets and liabilities:		
(Increase) decrease in accounts receivable, net and unbilled revenues	**(795)**	99
Decrease in materials and supplies	**4**	11
Increase in prepaid and other current assets	**(3)**	(2)
(Decrease) increase in accounts payable - trade	**(418)**	591
Increase in other current liabilities	**635**	114
Other, net	**(453)**	188
Net cash provided by operating activities	**$ 2,746**	$ 4,739
Investing activities:		
Plant expenditures, excluding allowance for funds used during construction	**$(2,706)**	$(3,380)
Other investing activities	**(11)**	1
Net cash used in investing activities	**$(2,717)**	$(3,379)
Financing activities:		
Long-term debt retirements	**$(1,520)**	$(1,510)
Changes in short-term debt due to affiliates	**1,725**	250
Net cash provided by (used in) financing activities	**$ 205**	$(1,260)
Net increase in cash and cash equivalents	**$ 234**	$ 100
Cash and cash equivalents at beginning of period	**178**	78
Cash and cash equivalents at end of year	**$ 412**	$ 178
Supplementary information:		
Interest paid	**$ 1,482**	$ 1,579
Federal and state income taxes paid	**$ 400**	$ 269

The accompanying notes are an integral part of these financial statements.

Nantucket Electric Company

Notes to Financial Statements

Note A - Significant Accounting Policies

1. Nature of Operations:
Nantucket Electric Company (the Company) is a wholly owned subsidiary of National Grid USA (National Grid) operating in Massachusetts. The Company's business is the distribution of electricity at retail. Electric service is provided to approximately 11,400 customers on Nantucket Island which has a year-round population of approximately 9,500 (2000 Census) and a seasonal tourist population which peaks at approximately 60,000 during the summer. The Company's service area covers the entire island. The properties of the Company consist principally of substations and distribution lines, including a 26-mile undersea electric cable (the "Nantucket Cable Project") which connects Nantucket Island to the mainland electric grid. Pursuant to legislation enacted in Massachusetts and settlement agreements approved by state and federal regulators (Massachusetts Settlement), effective March 1, 1998, the Company amended its all-requirements contract with New England Power Company (NEP), the Company's transmission affiliate, under which it had previously purchased all of its electric energy requirements. Under the Massachusetts Settlement, NEP recovers its above-market generation commitments through a contract termination charge, which the Company collects from its distribution customers.

2. System of Accounts:
The accounts of the Company are maintained in accordance with the Uniform System of Accounts prescribed by regulatory bodies having jurisdiction.

In preparing the financial statements, management is required to make estimates that affect the reported amounts of assets and liabilities and disclosures of asset recovery and contingent liabilities as of the date of the balance sheets and revenues and expenses for the period. These estimates may differ from actual amounts if future circumstances cause a change in the assumptions used to calculate these estimates. In addition, certain reclassifications have been made to conform the prior year with the 2004 presentation.

3. Electric Utility Revenue:
Revenues are based on billing rates authorized by the Massachusetts Department of Telecommunications and Energy (MDTE). The Company follows the policy of accruing the estimated amount of base rate revenues for electricity delivered but not yet billed (unbilled revenues), to match costs and revenues more closely. During 2004 and 2003, the Company recorded revenues in an amount management believes to be recoverable pursuant to provisions of approved settlement agreements and the Massachusetts Electric Industry Restructuring Act. The Company normalizes the difference between revenue and expenses from energy conservation programs, standard offer/default service, transmission service, and contract termination charges.

4. Allowance for Funds Used During Construction (AFUDC):
The Company capitalizes AFUDC as part of construction costs. AFUDC represents an allowance for the cost of funds used to finance construction. AFUDC is capitalized in "Utility plant" with offsetting non-cash credits to "Interest". This method is in accordance with an established rate-making practice under which a utility is permitted a return on, and the recovery of, prudently incurred capital costs through their ultimate inclusion in rate base and in the provision for depreciation. The composite AFUDC rates were 1.2 percent and 1.9 percent for the years ended March 31, 2004 and 2003, respectively.

5. Depreciation:
Depreciation is provided annually on a straight-line basis. Depreciation expense for the years ended March 31, 2004 and 2003 was approximately $2.3 million and $2.2 million, respectively. Depreciation as

a percentage of weighted average depreciable property was 4.8 percent and 4.6 percent for the years ended March 31, 2004 and 2003, respectively.

6. Cash and Cash Equivalents:
The Company classifies short-term investments with a maturity of 90 days or less at time of purchase as cash and cash equivalents.

7. Related Party Reimbursement:
In accordance with the Credit and Operating Support Agreement dated March 26, 1996 between the Company and the Company's distribution affiliate, Massachusetts Electric Company (Massachusetts Electric), following the end of each fiscal year, Massachusetts Electric will reimburse the Company an amount equal to the difference between the Company's actual net income for the fiscal year and the net income necessary for the Company to earn a return on common equity (ROE) equivalent to Massachusetts Electric's MDTE approved weighted average allowed ROE for the fiscal year, currently 11 percent. Actual net income for the year will exclude the impacts of any acquisition adjustment amortization. Notwithstanding the above, to the extent the Company's actual ROE for the year, excluding the acquisition adjustment amortization, exceeds the Company's allowed ROE, there will be no reimbursement. This reimbursement shall constitute additional revenue to the Company and an expense to Massachusetts Electric. As a result, for the years ended March 31, 2004 and 2003, Massachusetts Electric reimbursed the Company $1.8 million and $2.8 million, respectively.

8. Utility Plant:
The cost of additions to utility plant and replacements of retirement units of property are capitalized. Costs include direct material, labor, overhead and AFDC. Replacement of minor items of utility plant and the cost of current repairs and maintenance are charged to expense. Whenever utility plant is retired, its original cost, together with the cost of removal, less salvage, is charged to accumulated depreciation.

9. Goodwill:
In accordance with Statement of Financial Accounting Standards (SFAS) No. 142 "Goodwill and Other Intangible Assets", the Company reviews its goodwill annually for impairment and when events or circumstances indicate that the asset may be impaired. The Company utilized a discounted cash flow approach incorporating its most recent business plan forecasts in the performance of the annual goodwill impairment test. The result of the annual analysis determined that no adjustment to the goodwill carrying value was required.

10. Income Taxes:
Income taxes have been computed utilizing the asset and liability approach that requires the recognition of deferred tax assets and liabilities for the tax consequences of temporary differences by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities (see Note E).

11. Additional Minimum Pension Liability:
SFAS No. 87 "Employers' Accounting for Pensions" states that if a pension plan's accumulated benefit obligation (ABO) exceeds the fair value of plan assets, the employer shall recognize in the statement of financial position a liability that is at least equal to the unfunded ABO with an offsetting charge to a pension intangible, to the extent the plan has an unrecognized prior service cost, and to other comprehensive income. (see Note D and Note I).

12. New Accounting Standards:
In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143, "Accounting for

Asset Retirement Obligations" (FAS 143). FAS 143 provides the accounting requirements for retirement obligations associated with tangible long-lived assets. FAS 143 is effective for fiscal years beginning after June 15, 2002. The Company adopted FAS 143 during the current fiscal year. The adoption of this statement did not have a material impact on the Company's financial position, results of operations, or cash flows.

In December 2003 the FASB revised SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits" (FAS 132-R). FAS 132-R retains the disclosure requirements contained in the original statement and adds new disclosures about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension and other defined benefit postretirement plans. The FAS 132-R is effective for fiscal years ending after December 15, 2003 and for interim periods beginning thereafter. The Company has adopted FAS 132-R during the current fiscal year. This standard does not change the measurement or recognition of the aforementioned plans and, as such, the adoption of this statement has not had any effect on the Company's financial position, results of operations, or cash flows.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an interpretation of ARB 51" (FIN 46). FIN 46 requires the consolidation of entities in which an enterprise absorbs a majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both, as a result of ownership, contractual or other financial interest in the entity. Historically, entities have generally been consolidated by an enterprise when it has a controlling financial interest through ownership of a majority voting interest in the entity. The objectives of FIN 46 are to provide guidance on the identification of variable interest entities (VIEs) for which control is achieved through means other than a controlling financial interest, and how to determine which business enterprise, as the primary beneficiary, should consolidate the VIE. This new model for consolidation applies to an entity in which either (1) the entity lacks sufficient equity to absorb expected losses without additional subordinated financial support or (2) its at-risk equity holders as a group are not able to make decisions that have a significant impact on the success or failure of the entity's ongoing activities.

In December 2003, the FASB modified FIN 46 with FIN 46-R to make certain technical corrections to the standard and to address certain implementation issues. FIN 46, as originally issued, was effective immediately for VIEs created or acquired after January 31, 2003. FIN 46-R delayed the effective date of the interpretation to no later than March 31, 2004 (for calendar-year enterprises), except for special purpose entities for which the effective date was December 31, 2003. The adoption of FIN 46-R has not had a material impact on the Company's financial position, results of operations, or cash flows.

In January 2004, the FASB issued Staff Position No. 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act)" (FSP 106-1). FSP 106-1 is effective for annual fiscal periods ending after December 7, 2003. FSP 106-1 permits employers that sponsor postretirement benefit plans (plan sponsors) that provide prescription drug benefits to retirees to make a one-time election to defer accounting for any effects of the Act. FSP 106-1 requires all plan sponsors to provide certain disclosures, regardless of whether they choose to account or defer accounting. If deferral is elected, the deferral must remain in effect until the earlier of (1) the issuance of guidance by the FASB on how to account for the federal subsidy to be provided to plan sponsors under the Act or (2) the remeasurement of plan assets and obligations subsequent to January 31, 2004. The Company has decided not to make an election until further accounting guidance is issued by the FASB. The measurement of the accumulated postretirement benefit obligation and net postretirement benefit cost in the financial statements and accompanying notes do not reflect the effect of the Act on the Company's postretirement benefit plans.

Nantucket Electric Company

Notes to Financial Statements

13. Comprehensive Income
Comprehensive income consists of net income and other gains and losses affecting common equity that, under generally accepted accounting principles, are excluded from net income. For the Company, the components of accumulated other comprehensive loss consist of unrealized gains and losses on marketable equity investments and the impact of an additional minimum pension liability.

Note B - Regulatory Environment and Accounting Implications

Rates for services rendered by the Company for the most part are subject to approval by the MDTE. In March 2000, the MDTE approved a long-term rate plan for the Company and Massachusetts Electric, which became effective on May 1, 2000. The plan reduced distribution rates by $10 million for the combined companies with such rates being frozen through February 2005. Under the plan, from March 2005 to the end of December 2009, distribution rates will be increased by $10 million and subsequently adjusted by the annual percentage change in an index comprised of the weighted average of distribution rates of similarly unbundled investor-owned utilities in New England, New York, New Jersey and Pennsylvania. Under this index mechanism, the Company has also agreed that its distribution rates will be capped at 90% of that regional average. Based on a predetermined formula, annual savings in the Company's cost of service that are achieved by 2009 will be calculated and shared equitably with customers from January 2010 until May 2020. In addition, customers of Nantucket Electric pay a surcharge, which represents the Company's costs of owning and operating a submarine cable connecting the island to the mainland transmission grid.

Because electric utility rates have historically been based on a utility's costs, electric utilities are subject to certain accounting standards that are not applicable to other business enterprises in general. The Company applies the provisions of SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation", which requires regulated entities, in appropriate circumstances, to establish regulatory assets or liabilities, and thereby defer the income statement impact of certain charges or revenues because they are expected to be collected or refunded through future customer billings.

The components of regulatory assets (liabilities) are as follows:

At March 31 (In thousands)	**2004**	2003
Regulatory assets included in accounts receivable - other:		
Rate adjustment mechanisms	**$3,061**	$2,500
Regulatory (liabilities) included in other accrued expenses:		
Rate adjustment mechanisms	**(2,968)**	(2,119)
Total regulatory assets current, net	**93**	381
Regulatory assets included in deferred charges and other assets:		
Extraordinary property losses	**733**	962
Environmental response fund	**-**	88
Regulatory (liabilities) included in other reserves and deferred credits:		
Deferred FAS No. 109	**(649)**	(655)
Revaluation - Pensions and OPEB	**(122)**	(145)
Total regulatory assets (liabilities) long term, net	**(38)**	250
Net regulatory assets	**$ 55**	$ 631

Nantucket Electric Company

Notes to Financial Statements

Note C - Commitments and Contingencies

1. Plant Expenditures:
The Company's utility plant expenditures are estimated to be approximately $11.2 million in fiscal 2005. At March 31, 2004, substantial commitments had been made relative to future planned expenditures.

2. Hazardous Waste:
The Federal Comprehensive Environmental Response, Compensation and Liability Act, more commonly known as the "Superfund" law, imposes strict, joint and several liability, regardless of fault, for remediation of property contaminated with hazardous substances. A number of states, including Massachusetts, have enacted similar laws.

The electric utility industry typically utilizes and/or generates in its operations a range of potentially hazardous products and by-products. The Company currently has in place an internal environmental audit program and an external waste disposal vendor audit and qualification program intended to enhance compliance with existing federal, state, and local requirements regarding the handling of potentially hazardous products and by-products.

The Company has been named as a potentially responsible party by the Massachusetts Department of Environmental Protection for a site at which hazardous waste is alleged to have been disposed. This site, located on the Company's Candle Street property, was a former manufactured gas plant and is currently utilized for petroleum storage for the Company. The site soils contain coal tars and petroleum from its previous and current uses.

In 1993, the MDTE approved a settlement agreement that provides for rate recovery of remediation costs of former manufactured gas sites and certain other hazardous waste sites located in Massachusetts. Under that agreement, qualified costs related to this site are paid out of a fund which was established on Massachusetts Electric's books. Accordingly, those estimated costs have been recorded as a liability on Massachusetts Electric's books and not on the Company's books. However, certain other clean-up costs not designated as environmental response costs at the Candle Street site are not recoverable from the Massachusetts Electric fund but under the agreement are to be included with certain other Candle Street costs to be amortized and recovered over a period not to exceed 10 years.

Predicting the potential costs to investigate and remediate hazardous waste sites continues to be difficult. The Company has recovered amounts from an insurer, and, where appropriate, the Company intends to seek recovery from other insurers, but it is uncertain whether, and to what extent, such efforts will be successful. The Company believes that hazardous waste liabilities for all sites of which it is aware, and which are not covered by a rate agreement, are not material to its financial position.

Note D - Employee Benefits

1. Pension and Other Postretirement Benefits

Summary. The Company has a non-contributory defined benefit pension plan covering substantially all employees. The pension is a noncontributory, tax-qualified defined benefit plan which provides all employees of National Grid and its subsidiaries with a minimum retirement benefit. Under the pension plan a participant's retirement benefit is computed using formulas based on percentages of highest average compensation computed over five consecutive years. The compensation covered by the pension plan includes salary, bonus and incentive share awards. Supplemental nonqualified, non-contributory executive retirement programs provide additional defined pension benefits for certain executives.

Nantucket Electric Company

Notes to Financial Statements

The Company provides health care and life insurance coverage to eligible retired employees. Eligibility is based on certain age and length of service requirements and in some cases retirees must contribute to the cost of their coverage.

Funding Policy. Absent unusual circumstances, the Company's funding policy is to contribute each year the maximum tax-deductible amount for that year. However, the contribution for any year will not be less than the minimum contribution required by federal law or greater than the maximum tax-deductible amount.

Investment Strategy. The Company manages its pension and postretirement benefit plans' investments to minimize the long-term cost of operating the plan, with a reasonable level of risk. Risk tolerance is determined as a result of a periodic asset/liability study which analyzes plan liabilities and plan funded status and results in the determination of the allocation of assets across equity and fixed income. Equity investments are broadly diversified across U.S. and non-U.S. stocks, as well as across growth, value, and small and large capitalization stocks. Likewise, the fixed income portfolio is broadly diversified across the various fixed income market segments. Small investments are also held in private equity, real estate and timber, with the objective of enhancing long-term returns while improving portfolio diversification. Investment risk and return is reviewed by an investment committee on a quarterly basis.

The target asset allocation for the pension plan is:

	2004	**2003**
U.S. Equities	**42%**	50%
Global Equities (including U.S.)	**7%**	-
Non-U.S. Equities	**11%**	15%
Fixed Income	**35%**	35%
Private Equity and Property	**5%**	-
Total	**100%**	100%

The target asset allocation for the postretirement benefit plan is:

	2004	**2003**
U.S. Equities	**45%**	45%
Non-U.S. Equities	**15%**	15%
Fixed Income	**40%**	40%
Total	**100%**	100%

Expected Rate of Return on Assets. The estimated rate of return for various passive asset classes is based both on analysis of historical rates of return and forward looking analysis of risk premiums and yields. Current market conditions, such as inflation and interest rates, are evaluated in connection with the setting of our long-term assumption. A small premium is added for active management of both equity and fixed income. The rates of return for each asset class are then weighted in accordance with our target asset allocation, and the resulting long-term return on asset rate is then applied to the market-related value of assets.

The benefit plans' costs used the following assumptions:

Pension Benefits

For the year ended March 31,	**2004**	2003
Weighted average assumptions used to determine net periodic cost:		
Discount rate	**6.25%**	7.50%
Rate of compensation increase		
Union	**4.00%**	4.00%
Non-Union	**5.25%**	5.25%
Expected return on plan assets	**8.50%**	8.75%

Other Postretirement Benefits

For the year ended March 31,	**2004**	2003
Weighted average assumptions used to determine net periodic cost:		
Discount rate	**6.25%**	7.50%
Expected return on plan assets		
Union	**8.75%**	9.00%
Non-Union	**7.25%**	7.50%
Medical trend		
Initial	**10.00%**	10.00%
Ultimate	**5.00%**	5.00%
Year ultimate rate reached	**2008**	2007

The Company's pension cost for the years ended March 31, 2004 and 2003 included the following components:

	Year Ended March 31,	
(In thousands)	**2004**	2003
Service cost – benefits earned during the period	**$ 127**	$ 94
Plus (less):		
Interest cost on projected benefit obligation	**268**	243
Return on plan assets at expected long-term rate	**(288)**	(291)
Amortization of prior service cost	**4**	4
Amortization of net loss	**83**	-
Curtailment loss	**10**	-
Pension cost	**$ 204**	$ 50
Special termination benefits	**$ 214**	$ -

The Company's total cost of postretirement benefits other than pensions (PBOPs) for the years ended March 31, 2004 and 2003 included the following components:

(In thousands)	Year Ended March 31, **2004**	2003
Service cost - benefits earned during the period	**$ 20**	$ 13
Plus (less):		
Interest cost on projected benefit obligation	**33**	35
Amortization of prior service cost	**(1)**	(1)
Amortization of net (gain) loss	**105**	-
Postretirement benefit cost	**$ 157**	$ 47

The funded status of the pension plan cannot be presented separately for the Company as the Company participates in the plan with certain other National Grid subsidiaries.

The following table provides the changes in the National Grid companies' pension plan's fair value of assets for the fiscal years ended March 31, 2004 and 2003, and the percentage distribution of the fair market value of the types of assets held in the pension plan's trust. The expected contribution to the National Grid companies' pension plan during fiscal 2005 is approximately $50 million.

(In millions)	Year Ended March 31, **2004**	2003
Reconciliation of change in plan assets:		
Fair value of plan assets at beginning of period	**$ 869**	$ 1,053
Actual return (loss) on plan assets during year	**256**	(110)
Company contributions	**75**	8
Benefits paid from plan assets	**(98)**	(82)
Fair value of plan assets at end of period	**$ 1,102**	$ 869

	2004	2003
Distribution of plan assets:		
Debt securities	**34%**	39%
Equity securities	**63%**	58%
Property/real estate	**1%**	1%
Other	**2%**	2%
	100%	100%

The following table provides the changes in the Company's portion of the National Grid companies' postretirement plan's fair value of assets for the fiscal years ended March 31, 2004 and 2003, and the percentage distribution of the fair market value of the types of assets held in the postretirement plan's trust. The Company does not expect to make a contribution to the postretirement plan during fiscal 2005.

Nantucket Electric Company

Notes to Financial Statements

(In thousands)	**2004**	2003
Reconciliation of change in plan assets:		
Fair value of plan assets at beginning of period	**$1**	$1
Fair value of plan assets at end of period	**$1**	$1

Year ended March 31,	**2004**	2003
Distribution of plan assets:		
Debt securities	**38%**	55%
Equity securities	**61%**	44%
Other	**1%**	1%
	100%	100%

The following table provides a reconciliation of the changes in the National Grid companies' pension plan's benefit obligations, the accumulated benefit obligation and the assumptions used in developing those obligations for the National Grid companies' pension plan at March 31:

	Year Ended March 31,	
(In millions)	**2004**	2003
Accumulated benefit obligation	**$ 1,249**	$ 1,125
Change in benefit obligation:		
Benefit obligation at beginning of period	**$ 1,258**	$ 1,074
Service cost	**20**	15
Interest cost	**78**	78
Actuarial loss	**93**	173
Benefits paid	**(98)**	(82)
Curtailments	**(4)**	-
Special termination benefits	**78**	-
Benefit obligation at end of period	**$ 1,425**	$ 1,258
Reconciliation of prepaid cost		
Fair value of plan assets at end of period	**$ 1,102**	$ 869
Funded status	**$ (323)**	$ (389)
Unrecognized actuarial loss	**543**	646
Unrecognized prior service cost	**14**	17
Net amount recognized	**$ 234**	$ 274
Amounts recognized on the balance sheet consist of:		
Accrued benefit liability	**$ (148)**	$ (255)
Intangible asset	**16**	18
Regulatory assets	**62**	92
Accumulated other comprehensive income	**304**	419
Net amount recognized	**$ 234**	$ 274

Year ended March 31	2004	2003
Assumptions used to determine pension benefit obligation:		
Discount rate	**5.75%**	6.25%
Average rate of increase in future compensation level		
Union	**4.00%**	4.00%
Non-Union	**5.25%**	5.25%
Expected long-term rate of return on assets	**8.50%**	8.50%

The following provides a reconciliation of the Company's portion of the National Grid companies' postretirement benefit obligations and plan assets at March 31:

(In thousands)	2004	2003
Change in benefit obligation:		
Benefit obligation at beginning of period	**$ 607**	$ 478
Service cost	**20**	13
Interest cost	**33**	35
Actuarial (gain) loss	**(7)**	97
Benefits paid	**(46)**	(16)
Benefit obligation at end of period	**$ 607**	$ 607
Reconciliation of accrued cost:		
Fair value of plan assets at end of period	**$ 1**	$ 1
Funded status	**(606)**	(606)
Unrecognized prior service costs (benefit)	**(14)**	135
Net (gain) loss not yet recognized	**25**	(12)
Net amount accrued	**$ (595)**	$ (483)

Year ended March 31,	2004	2003
Weighted average assumptions to determine postretirement benefit obligation:		
Discount rate	**5.75%**	6.25%
Expected long-term rate of return on assets		
Union	**9.50%**	8.75%
Non-Union	**5.75%**	7.25%
Health Care Cost Trend		
Initial	**10.00%**	10.00%
Ultimate	**5.00%**	5.00%
Year ultimate reached	**2009**	2008

The assumptions used in the health care cost trends have a significant effect on the amounts reported. A one percentage point change in the assumed rates would increase the accumulated postretirement benefit obligation (APBO) as of March 31, 2004 by approximately $80,000 or decrease the APBO by approximately $70,000, and increase or decrease the postretirement benefit cost for 2004 by approximately $10,000.

2. Additional Minimum Liability (AML): SFAS 87 "Employers' Accounting for Pensions" states that if a pension plans ' ABO exceeds the fair value of plan assets, the employer shall recognize in the statement of financial position a liability that is at least equal to the unfunded ABO with an offsetting charge to other comprehensive income. Due to the severe downturn in the capital markets the Company's ABO at March 31, 2004 and 2003 is greater than the fair value of plan assets. If in the future, capital markets recover such that the fair value of plan assets is once again greater than the ABO, the additional minimum pension liability will be removed from the Company's balance sheets. At years ended March 31, 2004 and 2003, the Company has recognized an additional minimum pension liability of $1.2 million and $.07 million, respectively, on its balance sheet in other reserves and deferred credits reflecting the under funded pension obligation. (See Note I)

The Company has also recognized an allocated share of the additional minimum pension liability of its affiliated service company of $448,000 and $355,000 at years ended March 31, 2004 and 2003, respectively, which is recorded in accounts payable on the balance sheet with an offsetting charge to other comprehensive income.

3. Voluntary Early Retirement

In fiscal year 2003, National Grid USA companies made voluntary early retirement offers (VEROs). The VEROs were made to eligible both union and non-union employees with a total of 717 employees accepting the VERO offerings. The majority of them will retire by November 1, 2004, with the remainder retiring no later than January 1, 2008.

The Company's total VERO expense for union and non-union employees in fiscal year 2004 was approximately $.5 million which is included in "Other operation" in the accompanying Statement of Income.

Note E - Income Taxes

The Company and other subsidiaries participate with National Grid General Partnership, a wholly owned subsidiary of National Grid Group plc, in filing consolidated federal income tax returns. The Company's income tax provision is calculated on a separate return basis.

Total income taxes in the statements of income are as follows:

Year ended March 31,(In thousands)	**2004**	2003
Income taxes charged to operations	**$ 538**	$ 873
Income taxes charged to "Other income"	**20**	21
Total income taxes	**$ 558**	$ 894

Total income taxes, as shown above, consist of the following components:

Year ended March 31,(In thousands)	**2004**	2003
Current income taxes	**$ 177**	$ 447
Deferred income taxes	**396**	463
Investment tax credits, net	**(15)**	(16)
Total income taxes	**$ 558**	$ 894

Investment tax credits have been deferred and are being amortized over the estimated lives of the property giving rise to the credits.

Total income taxes, as shown above, consist of federal and state components as follows:

Nantucket Electric Company

Notes to Financial Statements

Year ended March 31,(In thousands)	**2004**	2003
Federal income taxes	**$ 462**	$ 562
State income taxes	**96**	332
Total income taxes	**$ 558**	$ 894

Consistent with rate-making policies of the MDTE, the Company has adopted comprehensive inter-period tax allocation (normalization) for temporary book/tax differences.

Total income taxes differ from the amounts computed by applying the federal statutory tax rates to income before taxes. The reasons for the differences are as follows:

Year Ended March 31, (In thousands)	**2004**	2003
Computed tax at statutory rate	**$ 511**	$ 625
Increases (reductions) in tax resulting from:		
Amortization of investment tax credits	**(15)**	(16)
State income tax, net of federal income tax benefit	**62**	216
Prior year tax adjustment	**-**	54
Book versus tax depreciation not normalized	**-**	2
All other differences	**-**	13
Total income taxes	**$ 558**	$ 894

Nantucket Electric Company

Notes to Financial Statements

The Company applies the provisions of SFAS No. 109, “Accounting for Income Taxes”, which requires recognition of deferred income taxes for temporary differences that are reported in different years for financial reporting and tax purposes using the liability method. Under the liability method, deferred tax liabilities or assets are computed using the tax rates that will be in effect when temporary differences reverse. Generally, for regulated companies, the change in tax rates may not be immediately recognized in operating results because of rate-making treatment and provisions in the Tax Reform Act of 1986. The following table identifies the major components of total deferred income taxes:

At March 31, (In millions)	**2004**	2003
Deferred tax asset:		
Plant related	**$ 257**	$ 160
Investment tax credits	**26**	33
Employee benefits	**-**	574
FAS 109 regulatory liability	**-**	337
All other	**2,348**	1,312
Total deferred tax assets	**2,631**	$2,416
Deferred tax liability:		
Plant related	**(3,297)**	(3,946)
FAS 109 regulatory asset	**(40)**	(80)
All other	**(1,893)**	(1,009)
Total deferred tax liability	**(5,230)**	(5,035)
Net deferred tax liability	**$ (2,599)**	$ (2,619)

There were no valuation allowances for deferred tax assets deemed necessary at March 31, 2004 and 2003.

Note F - Short-term Borrowings and Other Accrued Expenses

At March 31, 2004 and 2003, the Company had approximately $2.6 million and $0.8 million, respectively, of short-term debt outstanding to affiliates. The Company has regulatory approval from the Securities and Exchange Commission, under the Public Utility Holding Company Act of 1935 (1935 Act), to issue up to $6 million of short-term debt. National Grid and certain subsidiaries, including the Company, with regulatory approval, operate a money pool to more effectively utilize cash resources and to reduce outside short-term borrowings. Short-term borrowing needs are met first by available funds of the money pool participants. Borrowing companies pay interest at a rate designed to approximate the cost of outside short-term borrowings. Companies that invest in the pool share the interest earned on a basis proportionate to their average monthly investment in the money pool. Funds may be withdrawn from or repaid to the pool at any time without prior notice.

The weighted average rate on outstanding short-term borrowings was 1.1 and 1.7 percent at March 31, 2004 and 2003, respectively. The fair value of the Company’s short-term debt equals carrying value.

Nantucket Electric Company

Notes to Financial Statements

The components of other accrued expenses are as follows:

At March 31, (In millions)	**2004**	2003
Rate adjustment mechanisms	**$ 2,968**	$ 2,119
Accrued wages and benefits	**245**	222
Total other accrued expenses	**$ 3,213**	$ 2,341

Note G - Long-term Debt

A summary of long-term debt is as follows:

At March 31 (In thousands)	Rate %	Maturity	**2004**	2003
	5.200	July 1, 2003	**$ -**	$ 1,400
	5.300	July 1, 2004	**1,400**	1,400
	6.750	July 1, 2005	**1,400**	1,400
	6.750	July 1, 2006	**1,400**	1,400
	5.600	July 1, 2007	**1,400**	1,400
	5.750	July 1, 2008	**1,400**	1,400
	5.750	July 1, 2009	**1,400**	1,400
	8.500	See following table	**2,775**	2,895
	5.875	See following table	**10,500**	10,500
Unamortized discounts			**(85)**	(91)
Total long-term debt			**$ 21,590**	$ 23,104
Long-term debt due within one year			**1,535**	1,400
Total long-term debt, excluding current portion			**$ 20,055**	$ 21,704

Sinking fund requirements of the 5.875 percent bond and the 8.500 percent bond are as follows:

	Principal Amount (In thousands)	
March 1, 2005	$ 135	
March 1, 2006	145	
March 1, 2007	160	
March 1, 2008	175	
March 1, 2009	195	
March 1, 2010	1,610	
March 1, 2011	1,630	
March 1, 2012	1,650	
March 1, 2013	1,675	
March 1, 2014	1,705	
March 1, 2015	1,730	
March 1, 2016	1,765	
March 1, 2017	700	(maturity)
	$ 13,275	

The Company will make cash payments of $1.5 million in fiscal 2005, $1.5 million in fiscal 2006, $1.6 million in fiscal 2007, $1.6 million in fiscal 2008, $1.6 million in fiscal 2009, and $13.9 million thereafter to retire maturing bonds and to meet sinking fund obligations.

At March 31, 2004 and 2003, the Company's long-term debt had a carrying value of approximately $21.7 million and $23.2 million and had a fair value of approximately $23 million and $25 million, respectively. The fair market value of the Company's long-term debt was estimated based on the quoted prices for similar issues or on the current rates offered to the Company for debt of the same remaining maturity.

Note H - Supplementary Income Statement Information

Advertising expenses, expenditures for research and development, and rents were not material and there were no royalties paid in the years ended March 31, 2004 or 2003. Taxes, other than income taxes, charged to operating expenses are set forth by class as follows:

Year ended March 31,(In thousands)	**2004**	2003
Municipal property taxes	**$ 296**	$ 310
Federal and state payroll and other taxes	**131**	130
Total taxes, other than income taxes	**$ 427**	$ 440

National Grid USA Service Company, Inc., an affiliated service company operating pursuant to the provisions of Section 13 of the 1935 Act, furnished services to the Company at the cost of such services. These costs amounted to $2.1 million and $1.7 million, including capitalized construction costs of $263,000 and $319,000, for the years ended March 31, 2004, and 2003, respectively.

Note I – Accumulated Other Comprehensive Income (Loss)

(*In Thousands*)	Unrealized Gain (Loss) on Available-for-Sale Securities	Minimum Pension Liability Adjustment	Total Accumulated Other Comprehensive Income (Loss)
March 31, 2002	$ (7)	$ -	$ (7)
Other comprehensive loss:			
Unrealized losses on securities, net of taxes	(20)	-	(20)
Change in minimum pension liability, net of taxes	-	(399)	(399)
March 31, 2003	$ (27)	$ (399)	$ (426)
Other comprehensive income (loss):			
Unrealized gains on securities, net of taxes	30	-	30
Change in minimum pension liability, net of taxes	-	(762)	(762)
March 31, 2004	$ 3	$ (1,161)	$ (1,158)

NANTUCKET ELECTRIC COMPANY
Statement of Income
Year ended March 31, 2004 (In thousands)
(Actual and Pro Forma)
(Unaudited)

	Actual	Scenario #1	Scenario #2	Scenario #3	Pro-Forma
Operating revenue	$ 19,765			$ 4,500	$ 24,265
Operating expenses:					
Purchased electric energy:					
Non-affiliates	8,666				8,666
Contract termination charges from New England Power Company, an affiliate	1,019				1,019
Other operation	3,657				3,657
Maintenance	589				589
Depreciation	2,484			1,850	4,334
Taxes, other than income taxes	427				427
Income taxes	538	40	87	145	810
Total operating expenses	17,380	40	87	1,995	19,502
Operating income	2,385	(40)	(87)	2,505	4,763
Other income (expense):					
Other income (expense), net	46				46
Operating and other income	2,431	(40)	(87)	2,505	4,809
Interest:					
Interest on long-term debt	1,449	(101)	(222)	2,239	3,365
Other interest	91			64	155
Allowance for borrowed funds during construction	(20)				(20)
Total interest	1,520	(101)	(222)	2,303	3,500
Net income	$ 911	$ 61	$ 135	$ 203	1,310

Statement of Retained Earnings
Year ended March 31, 2004 (In thousands)
(Actual and Pro Forma)
(Unaudited)

	Actual	Scenario #1	Scenario #2	Scenario #3	Pro-Forma
Retained earnings at beginning of year	$ 1,624	$ -	$ -	$ -	$ 1,624
Net income	911	61	135	203	1,310
Dividends declared on cumulative preferred stock	-				-
Premium on redemption of preferred stock	-				-
Retained earnings at end of year	$ 2,535	$ 61	$ 135	$ 203	$ 2,934

NANTUCKET ELECTRIC COMPANY
Balance Sheet
March 31, 2004 (In thousands)
(Actual and Pro Forma)
(Unaudited)

	Actual	Scenario #1	Scenario #2	Scenario #3	Pro-Forma
Assets					
Utility plant, at original cost	$ 49,989			37,000	$ 86,989
Less accumulated provisions for depreciation	(17,812)			(1,850)	(19,662)
	32,177	-	-	35,150	67,327
Construction work in progress	3,002			(3,054)	(52)
Net utility plant	35,179	-	-	32,096	67,275
Goodwill	15,679				15,679
Pension intangible	50				50
Current assets:					
Cash and cash equivalents	412	101	222	281	1,016
Accounts receivable:					
From electric energy services, including unbilled revenues	4,427				4,427
Other (including $1,121 from affiliates)	1,126				1,126
Less reserves for doubtful accounts	(29)				(29)
	5,524				5,524
Materials and supplies, at average cost	192				192
Prepaid and other current assets	7			1,221	1,228
Total current assets	6,135	101	222	1,502	7,960
Deferred charges and other assets	2,143				2,143
Total assets	$ 59,186	101	222	33,598	$ 93,107
Capitalization and Liabilities					
Capitalization:					
Common stock, par value $1 per share,					
Authorized 1,200 shares					
Outstanding - 1 share	$ -				$ -
Other paid-in capital	22,481				22,481
Retained earnings	2,535	61	135	203	2,934
Accumulated other comprehensive loss	(1,158)				(1,158)
Total common equity	23,858	61	135	203	24,257
Long-term debt	20,055			31,500	51,555
Total capitalization	43,913	61	135	31,703	75,812
Current liabilities:					
Long-term debt due within one year	1,535			1,750	3,285
Short-term debt to affiliates	2,550				2,550
Accounts payable (including $104 to affiliates)	1,620				1,620
Accrued liabilities:					
Taxes	249	40	87	145	521
Deferred federal and state liabilities	86				86
Interest	309				309
Other accrued expenses	3,213				3,213
Customer deposits	22				22
Total current liabilities	9,584	40	87	1,895	11,606
Deferred federal and state income taxes	2,513				2,513
Unamortized investment tax credits	63				63
Accrued pension and other post-retirement benefits	1,211				1,211
Additional minimum pension liability	1,233				1,233
Other reserves and deferred credits	669				669
Commitments and contingencies	-				-
Total capitalization and liabilities	$ 59,186	101	222	33,598	93,107

Nantucket Electric Company
Financial Scenarios

Scenario # 1	$2.775 million of 8.5% tax exempt bonds refinanced with $2.775 million of 4.74% tax exempt
Scenario # 2	$14.7 million of tax exempt bond at a weighted average rate of 5.825%, refinanced with $14.7 million of tax exempt bonds at a weighted average rate of 4.21% during the 12-month period ending June 30, 2007.
Scenario # 3	$37 million cable project (new utility plant) financed with $2 million of internally generated funds and $35 million debt, $10 million of which is tax exempt (at average rate of 5.24%) and the remainder is taxable (at average rate of 6.71%). Debt service funded with cable surcharge.
Scenario # 4	$13.3 million of tax exempt bond at a weighted average rate of 5.85%, refinanced with $13.3 million of tax exempt bonds at a weighted average rate of 4.30% during the 12-month period ending June 30, 2008. (if Scenario #2 is not executed)

Scenario #1

Original Debt Interest Rate	
Interest Rate	8.500%
Refinanced Debt Interest Rate	
Interest Rate	4.740%
Principal Balance	$ 2,775,000
Annual Interest under Original Debt	(236,000)
Annual Interest under Refinanced Debt	(132,000)
Estimated annual Savings	104,000
Plus **New Annual Fees**	(3,000)
Tax Rate	
Tax-exempt bonds	39.2%
Annual Fees	39.2%
Tax Benefit/(Cost)	
Tax-exempt bonds	(41,000)
Annual fees	1,000
	(40,000)
Estimated annual savings/(cost), net	$ 61,000

Scenario #2

Original Debt Interest Rate	
Interest Rate	5.825%
Refinanced Debt Interest Rate	
Interest Rate	4.210%
Principal Balance	$ 14,700,000
Annual Interest under Original Debt	(856,000)
Annual Interest under Refinanced Debt	(619,000)
Estimated annual Savings	237,000
Plus **New Annual Fees**	(15,000)
Tax Rate	
Tax-exempt bonds	39.2%
Annual Fees	39.2%
Tax Benefit/(Cost)	
Tax-exempt bonds	(93,000)
Annual fees	6,000
	(87,000)
Estimated annual savings/(cost), net	$ 135,000

Scenario #3

Funds Raised	
Internally generated	$ 2,000,000
Tax-exempt bonds	10,000,000
Taxable bonds	25,000,000
Plant project	37,000,000
Interest rates	
Tax-exempt bonds	5.24%
Taxable bonds	6.71%
New Annual Interest Expense	
Tax-exempt bonds	(524,000)
Taxable bonds	(1,677,500)
Estimated annual Interest Expense	(2,201,500)
Plus **New Annual Fees**	(37,000)
Tax Rate	
Tax-exempt bonds	39.2%
Annual Fees	39.2%
Tax Benefit/(Cost)	
Tax-exempt bonds	864,000
Annual fees	15,000
	879,000
Estimated annual savings/(cost), before income effects	$ (1,359,500)

Scenario #4

Original Debt Interest Rate	
Interest Rate	5.850%
Refinanced Debt Interest Rate	
Interest Rate	4.300%
Principal Balance	$ 13,300,000
Annual Interest under Original Debt	(778,000)
Annual Interest under Refinanced Debt	(572,000)
Estimated annual Savings	206,000
Plus **New Annual Fees**	(13,000)
Tax Rate	
Tax-exempt bonds	39.2%
Annual Fees	39.2%
Tax-exempt bonds	(81,000)
Annual fees	5,000
	(76,000)
savings/(cost), net	$ 117,000

Annual Report 2004

Massachusetts Electric

A **National Grid** Company

Report of Independent Auditors

To the Stockholders and Board of Directors of
Massachusetts Electric Company, Northborough, Massachusetts:

In our opinion, the accompanying balance sheets and the related statements of income, of comprehensive income (loss), of retained earnings and of cash flows present fairly, in all material respects, the financial position of Massachusetts Electric Company, a wholly owned subsidiary of National Grid USA, at March 31, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP
PricewaterhouseCoopers LLP

Boston, Massachusetts
May 6, 2004

Massachusetts Electric Company

Statements of Income

Year ended March 31 (In thousands)	**2004**	2003
Operating revenue	**$1,993,505**	$1,734,576
Operating expenses:		
Purchased electric energy:		
Non-affiliates	**1,064,858**	807,090
Contract termination charges from New England Power Company, an affiliate	**188,849**	189,173
Other operation	**476,882**	400,225
Maintenance	**49,789**	49,898
Depreciation	**90,229**	86,285
Taxes, other than income taxes (Note J)	**38,083**	39,089
Income taxes (Note E)	**23,942**	52,873
Total operating expenses	**1,932,632**	1,624,633
Operating income	**60,873**	109,943
Other expense:		
Other expense, net	**(658)**	(1,312)
Operating and other income	**60,215**	108,631
Interest:		
Interest on long-term debt	**20,081**	24,973
Other interest	**5,376**	5,780
Total interest	**25,457**	30,753
Net income	**$ 34,758**	$ 77,878

Statements of Comprehensive Income (Loss)

Year ended March 31 (In thousands)	**2004**	2003
Net income	**$ 34,758**	$ 77,878
Other comprehensive income (loss):		
Unrealized gains (losses) on securities, net of taxes of $131 and ($53), respectively	**243**	(98)
Change in additional minimum pension liability, net of taxes of $19,386 and ($69,553), respectively	**28,876**	(152,728)
Comprehensive income (loss)	**$ 63,877**	$ (74,948)

Statements of Retained Earnings

Year ended March 31 (In thousands)	**2004**	2003
Retained earnings at beginning of year	**$ 169,472**	$ 92,182
Net income	**34,758**	77,878
Dividends declared on cumulative preferred stock	**(312)**	(597)
Premium on redemption of preferred stock	**(189)**	9
Retained earnings at end of year	**$ 203,729**	$ 169,472

The accompanying notes are an integral part of these financial statements.

Massachusetts Electric Company

Balance Sheets

At March 31 (In thousands)	2004	2003
Assets		
Utility plant, at original cost	**$ 2,342,310**	$ 2,235,106
Less accumulated provisions for depreciation	**(781,484)**	(723,443)
	1,560,826	1,511,663
Construction work in progress	**34,942**	17,456
Net utility plant	**1,595,768**	1,529,119
Goodwill	**1,023,272**	1,023,272
Pension intangible	**5,296**	6,435
Current assets:		
Cash and cash equivalents	**8,115**	9,852
Accounts receivable:		
From electric energy services, including unbilled revenues (Note A-3)	**301,954**	272,139
Other (including $8,256 and $7,047 from affiliates)	**14,722**	7,814
Less reserves for doubtful accounts	**(12,296)**	(12,991)
Total accounts receivable	**304,380**	266,962
Materials and supplies, at average cost	**9,682**	9,896
Prepaid and other current assets	**1,963**	2,146
Deferred federal and state income taxes (Note E)	**-**	17,761
Total current assets	**324,140**	306,617
Regulatory assets (Note B)	**48,017**	47,260
Prepaid pension	**107,122**	125,079
Deferred charges and other assets	**20,170**	18,962
Total assets	**$ 3,123,785**	$ 3,056,744
Capitalization and Liabilities		
Capitalization:		
Common stock, par value $25 per share, authorized and outstanding 2,398,111 shares	**$ 59,953**	$ 59,953
Other paid-in capital	**1,508,991**	1,508,991
Retained earnings	**203,729**	169,472
Accumulated other comprehensive loss (Note K)	**(123,665)**	(152,784)
Total common equity	**1,649,008**	1,585,632
Cumulative preferred stock, par value $100 per share (Note G)	**4,727**	10,127
Long-term debt (Note H)	**213,209**	283,060
Total capitalization	**1,866,944**	1,878,819
Current liabilities:		
Long-term debt due within one year (Note H)	**39,000**	15,000
Short-term debt to affiliates (Note F)	**220,575**	133,150
Accounts payable (including $92,376 and $92,522 to affiliates)	**232,790**	244,443
Accrued liabilities:		
Taxes	**15,611**	31,521
Deferred federal and state income taxes (Note E)	**1,458**	-
Interest	**5,045**	5,520
Other accrued expenses (Note F)	**34,894**	38,038
Customer deposits	**4,069**	4,290
Dividends payable	**54**	149
Total current liabilities	**553,496**	472,111
Deferred federal and state income taxes (Note E)	**176,174**	153,396
Unamortized investment tax credits	**10,726**	12,010
Accrued pension and other post-retirement benefits	**47,283**	37,302
Additional minimum pension liability	**131,503**	180,863
Other reserves and deferred credits	**337,659**	322,243
Commitments and contingencies (Note C)		
Total capitalization and liabilities	**$ 3,123,785**	$ 3,056,744

The accompanying notes are an integral part of these financial statements.

Massachusetts Electric Company

Statements of Cash Flows

Year ended March 31 (In thousands)	**2004**	2003
Operating activities:		
Net income	**$ 34,758**	$ 77,878
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	**90,229**	86,285
Deferred income taxes and investment tax credits, net	**22,919**	8,955
Allowance for borrowed funds used during construction	**(122)**	(194)
Changes in current operating assets and liabilities:		
(Increase) decrease in accounts receivable, net and unbilled revenues	**(37,418)**	54,415
Decrease (increase) in materials and supplies	**214**	(850)
Decrease in prepaid and other current assets	**183**	872
Decrease (increase) in prepaid pension	**17,957**	(4,488)
Increase in regulatory assets	**(757)**	(38,804)
Increase in deferred charges and other assets	**(1,734)**	(3,736)
(Decrease) increase in accounts payable - trade	**(11,653)**	16,773
Decrease in other current liabilities	**(19,750)**	(1,598)
Other, net	**15,160**	54,208
Net cash provided by operating activities	**$ 109,986**	$ 249,716
Investing activities:		
Plant expenditures, excluding allowance for funds used during construction	**$ (148,279)**	$ (132,974)
Proceeds received from sale of fixed assets	**202**	116
Other investing activities	**925**	2,310
Net cash used in investing activities	**$ (147,152)**	$ (130,548)
Financing activities:		
Dividends paid on preferred stock	**$ (407)**	$ (597)
Long-term debt – retirements	**(46,000)**	(70,000)
Preferred stock – retirements	**(5,400)**	(46)
Premium on redemption of preferred stock	**(189)**	9
Changes in short-term debt due to affiliates	**87,425**	(43,450)
Net cash provided by (used in) financing activities	**$ 35,429**	$ (114,084)
Net (decrease) increase in cash and cash equivalents	**$ (1,737)**	$ 5,084
Cash and cash equivalents at beginning of year	**9,852**	4,768
Cash and cash equivalents at end of year	**$ 8,115**	$ 9,852
Supplementary information:		
Interest paid, less amounts capitalized	**$ 22,835**	$ 29,081
Federal and state income taxes paid	**$ 16,043**	$ 11,521

The accompanying notes are an integral part of these financial statements.

Massachusetts Electric Company

Notes to Financial Statements

Note A - Significant Accounting Policies

1. Nature of Operations:
Massachusetts Electric Company (the Company) is a wholly owned subsidiary of National Grid USA (National Grid) operating in Massachusetts. The Company's business is the distribution of electricity at retail. Electric service is provided to approximately 1,217,000 customers in 171 cities and towns having a population of approximately 2,825,000 (2000 Census). The properties of the Company consist principally of substations and distribution lines interconnected with transmission and other facilities of New England Power Company (NEP), the Company's transmission affiliate. Pursuant to legislation enacted in Massachusetts and settlement agreements approved by state and federal regulators (Massachusetts Settlement), effective March 1, 1998, the Company amended its all-requirements contract with NEP, under which it had previously purchased all of its electric energy requirements. Under the Massachusetts Settlement, NEP recovers its above-market generation commitments through a contract termination charge (CTC), which the Company collects from its distribution customers.

2. System of Accounts:
The accounts of the Company are maintained in accordance with the Uniform System of Accounts prescribed by regulatory bodies having jurisdiction.

In preparing the financial statements, management is required to make estimates that affect the reported amounts of assets and liabilities and disclosures of asset recovery and contingent liabilities as of the date of the balance sheets and revenues and expenses for the period. These estimates may differ from actual amounts if future circumstances cause a change in the assumptions used to calculate these estimates. In addition, certain reclassifications have been made to conform the prior year with the 2004 presentation.

3. Electric Utility Revenue:
Revenues are based on billing rates authorized by the Massachusetts Department of Telecommunications and Energy (MDTE). The Company follows the policy of accruing the estimated amount of base rate revenues for electricity delivered but not yet billed (unbilled revenues), to match costs and revenues more closely. During 2004 and 2003, the Company recorded revenues in an amount management believes to be recoverable pursuant to provisions of approved settlement agreements and the Massachusetts Electric Industry Restructuring Act. The Company normalizes the difference between revenue and expenses from energy conservation programs, standard offer/default service, transmission service, and CTCs.

4. Allowance for Funds Used During Construction (AFUDC):
The Company capitalizes AFUDC as part of construction costs. AFUDC represents an allowance for the cost of funds used to finance construction. AFUDC is capitalized in "Utility plant" with offsetting noncash credits to "Interest". This method is in accordance with an established rate-making practice under which a utility is permitted a return on, and the recovery of, prudently incurred capital costs through their ultimate inclusion in rate base and in the provision for depreciation. The composite AFUDC rates were 1.1 percent and 1.5 percent for the years ended March 31, 2004 and 2003, respectively.

5. Depreciation:
Depreciation is provided annually on a straight-line basis. Depreciation expense for the years ended March 31, 2004 and 2003 was approximately $90 million and $86 million, respectively. Depreciation expense as a percentage of weighted average depreciable property was 4.0 percent for the years ended March 31, 2004 and 2003.

Massachusetts Electric Company

Notes to Financial Statements

6. Cash and Cash Equivalents:
The Company classifies short-term investments with a maturity of 90 days or less at time of purchase as cash and cash equivalents.

7. Utility Plant:
The cost of additions to utility plant and replacements of retirement units of property are capitalized. Costs include direct material, labor, overhead and AFUDC. Replacement of minor items of utility plant and the cost of current repairs and maintenance are charged to expense. Whenever utility plant is retired, its original cost, together with the cost of removal, less salvage, is charged to accumulated depreciation.

8. Goodwill:
In accordance with Statement of Financial Accounting Standards (SFAS) No. 142 "Goodwill and Other Intangible Assets", the Company reviews its goodwill annually for impairment and when events or circumstances indicate that the asset may be impaired. The Company utilized a discounted cash flow approach incorporating its most recent business plan forecasts in the performance of the annual goodwill impairment test. The result of the annual analysis determined that no adjustment to the goodwill carrying value was required.

9. Income Taxes:
Income taxes have been computed utilizing the asset and liability approach that requires the recognition of deferred tax assets and liabilities for the tax consequences of temporary differences by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities (see Note E).

10. Additional Minimum Pension Liability:
SFAS No. 87 "Employers' Accounting for Pensions" states that if a pension plan's accumulated benefit obligation (ABO) exceeds the fair value of plan assets, the employer shall recognize in the statement of financial position a liability that is at least equal to the unfunded ABO with an offsetting charge to a pension intangible, to the extent the plan has an unrecognized prior service cost, and to other comprehensive income. (see Note D and Note K).

11. New Accounting Standards:
In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143, "Accounting for Asset Retirement Obligations" (FAS 143). FAS 143 provides the accounting requirements for retirement obligations associated with tangible long-lived assets. FAS 143 is effective for fiscal years beginning after June 15, 2002. The Company adopted FAS 143 during the current fiscal year.

The Company does not have any material asset retirement obligations arising from legal obligations as defined under FAS 143. However, under the Company's current and prior rate plans it has collected through rates an implied cost of removal for its plant assets. This cost of removal collected from customers differs from the FAS 143 definition of an asset retirement obligation in that these collections are for costs to remove an asset when it is no longer deemed usable (i.e. broken or obsolete) and not necessarily from a legal obligation.

The collection of cost of removal collected from customers has historically been embedded within accumulated depreciation (as these costs have charged over time through depreciation expense). With the adoption of FAS 143 the Company has reclassified the cost of removal collections to a regulatory liability account to more properly reflect the future usage of these collections. The Company estimates it has collected over time approximately $117 million and $109 million for cost of removal through March 31, 2004 and 2003, respectively.

In December 2003, the FASB revised SFAS No. 132, “Employers’ Disclosures about Pensions and Other Postretirement Benefits” (FAS 132-R). FAS 132-R retains the disclosure requirements contained in the original statement and adds new disclosures about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension and other defined benefit postretirement plans. The FAS 132-R is effective for fiscal years ending after December 15, 2003 and for interim periods beginning thereafter. The Company has adopted FAS 132-R during the current fiscal year. This standard does not change the measurement or recognition of the aforementioned plans and, as such, the adoption of this statement has not had any effect on the Company’s financial position, results of operations, or cash flows.

In January 2003, the FASB issued Interpretation No. 46, “Consolidation of Variable Interest Entities, an interpretation of ARB 51” (FIN 46). FIN 46 requires the consolidation of entities in which an enterprise absorbs a majority of the entity’s expected losses, receives a majority of the entity’s expected residual returns, or both, as a result of ownership, contractual or other financial interest in the entity. Historically, entities have generally been consolidated by an enterprise when it has a controlling financial interest through ownership of a majority voting interest in the entity. The objectives of FIN 46 are to provide guidance on the identification of variable interest entities (VIEs) for which control is achieved through means other than a controlling financial interest, and how to determine which business enterprise, as the primary beneficiary, should consolidate the VIE. This new model for consolidation applies to an entity in which either (1) the entity lacks sufficient equity to absorb expected losses without additional subordinated financial support or (2) its at-risk equity holders as a group are not able to make decisions that have a significant impact on the success or failure of the entity’s ongoing activities.

In December 2003, the FASB modified FIN 46 with FIN 46-R to make certain technical corrections to the standard and to address certain implementation issues. FIN 46, as originally issued, was effective immediately for VIEs created or acquired after January 31, 2003. FIN 46-R delayed the effective date of the interpretation to no later than March 31, 2004 (for calendar-year enterprises), except for special purpose entities for which the effective date was December 31, 2003. The adoption of FIN 46-R has not had a material impact on the Company's financial position, results of operations, or cash flows.

In January 2004, the FASB issued Staff Position No. 106-1, “Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act)” (FSP 106-1). FSP 106-1 is effective for annual fiscal periods ending after December 7, 2003. FSP 106-1 permits employers that sponsor postretirement benefit plans (plan sponsors) that provide prescription drug benefits to retirees to make a one-time election to defer accounting for any effects of the Act. FSP 106-1 requires all plan sponsors to provide certain disclosures, regardless of whether they choose to account or defer accounting. If deferral is elected, the deferral must remain in effect until the earlier of (1) the issuance of guidance by the FASB on how to account for the federal subsidy to be provided to plan sponsors under the Act or (2) the remeasurement of plan assets and obligations subsequent to January 31, 2004. The Company has decided not to make an election until further accounting guidance is issued by the FASB. The measurement of the accumulated postretirement benefit obligation and net postretirement benefit cost in the financial statements and accompanying notes do not reflect the effect of the Act on the Company's postretirement benefit plans.

12. Comprehensive Income (Loss)
Comprehensive income (loss) consists of net income and other gains and losses affecting common equity that, under generally accepted accounting principles, are excluded from net income. For the Company, the components of accumulated other comprehensive income (loss) consist of unrealized gains and losses on marketable equity investments and additional minimum pension liability, net of taxes.

Massachusetts Electric Company

Notes to Financial Statements

Note B – Regulatory Environment and Accounting Implications

Rates for services rendered by the Company for the most part are subject to approval by the MDTE. In March 2000, the MDTE approved a long-term rate plan for the Company, which became effective on May 1, 2000. The plan reduced distribution rates by $10 million annually with such rates being frozen through February 2005. Under the plan, from March 2005 to the end of December 2009, distribution rates will be increased by $10 million and subsequently adjusted by the annual percentage change in an index comprised of the weighted average of distribution rates of similarly unbundled investor-owned utilities in New England, New York, New Jersey and Pennsylvania. Under this index mechanism, the Company has also agreed that its distribution rates will be capped at 90% of that regional average. Based on a predetermined formula, annual savings in the Company's cost of service that are achieved by 2009 will be calculated and shared equitably with customers from January 2010 until May 2020.

Because electric utility rates have historically been based on a utility's costs, electric utilities are subject to certain accounting standards that are not applicable to other business enterprises in general. The Company applies the provisions of SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation", which requires regulated entities, in appropriate circumstances, to establish regulatory assets or liabilities, and thereby defer the income statement impact of certain charges or revenues because they are expected to be collected or refunded through future customer billings.

The components of regulatory assets (liabilities) are as follows:

At March 31 (In thousands)	**2004**	2003
Regulatory assets included in account receivable - other:		
Rate adjustment mechanisms	**$ 105,448**	$ 61,644
Regulatory liabilities included in other accrued expenses:		
Rate adjustment mechanisms	**(10,201)**	(19,625)
Total net regulatory asset current	**95,247**	42,019
Regulatory assets:		
Unamortized losses on reacquired debt	**6,751**	6,921
Environmental response costs	**41,266**	40,339
Regulatory liabilities included in other reserves and deferred credits:		
Deferred FAS No. 109	**(2,926)**	(1,178)
Revaluation - Pensions and OPEB	**(60,486)**	(62,657)
Environmental response costs	**(56,437)**	(53,540)
Storm fund reserve	**(13,424)**	(10,179)
Cost of removal	**(117,245)**	(108,853)
Other	**(1,027)**	(4,808)
Total net regulatory liabilities long term	**(203,528)**	(193,955)
Net regulatory liabilities	**$ (108,281)**	$ (151,936)

Massachusetts Electric Company

Notes to Financial Statements

Note C - Commitments and Contingencies

1. Plant Expenditures:
The Company's utility plant expenditures are estimated to be approximately $140 million in 2005. At March 31, 2004, substantial commitments had been made relative to future planned expenditures.

2. Hazardous Waste:
The Federal Comprehensive Environmental Response, Compensation and Liability Act, more commonly known as the "Superfund" law, imposes strict, joint and several liability, regardless of fault, for remediation of property contaminated with hazardous substances. A number of states, including Massachusetts, have enacted similar laws.

The electric utility industry typically utilizes and/or generates in its operations a range of potentially hazardous products and by-products. The Company currently has in place an internal environmental audit program and an external waste disposal vendor audit and qualification program intended to enhance compliance with existing federal, state, and local requirements regarding the handling of potentially hazardous products and by-products.

The Company has been named as a potentially responsible party (PRP) by either the United States Environmental Protection Agency or the Massachusetts Department of Environmental Protection for a number of sites at which hazardous waste is alleged to have been disposed. Private parties have also contacted or initiated legal proceedings against the Company regarding hazardous waste cleanup. The most prevalent types of hazardous waste sites with which the Company has been associated are manufactured gas locations. The Company is aware of a number of such manufactured gas locations in Massachusetts, including some for which the Company has been identified as a PRP. The Company is engaged in various phases of investigation and remediation work at a number of the manufactured gas locations. The Company is currently aware of other possible hazardous waste sites, and may in the future become aware of additional sites, that it may be held responsible for remediating.

In 1993, the MDTE approved a settlement agreement that provides for rate recovery of remediation costs of former manufactured gas sites and certain other hazardous waste sites located in Massachusetts. Under that agreement, qualified costs related to these sites are paid out of a special fund established on the Company's books. Rate-recoverable contributions of approximately $5 million are added annually to the fund along with interest, lease payments, and any recoveries from insurance carriers and other third parties. At March 31, 2004 and 2003, the fund had a balance of approximately $56 million and $53 million, respectively.

Predicting the potential costs to investigate and remediate hazardous waste sites continues to be difficult. There are also significant uncertainties as to the portion, if any, of the investigation and remediation costs of any particular hazardous waste site that may ultimately be borne by the Company. The Company has recovered amounts from certain insurers, and, where appropriate, the Company intends to seek recovery from other insurers and from other PRPs, but it is uncertain whether, and to what extent, such efforts will be successful. At March 31, 2004 and 2003, the Company had total reserves for environmental response costs of approximately $52 million and $51 million, respectively, which includes reserves established in connection with the Company's hazardous waste fund referred to above. The Company believes that hazardous waste liabilities for all sites of which it is aware, and which are not covered by a rate agreement, are not material to its financial position.

Note D - Employee Benefits

1. Pension and Other Postretirement Benefits

Summary. The Company has a non-contributory defined benefit pension plan covering substantially all employees. The pension is a noncontributory, tax-qualified defined benefit plan which provides all employees of National Grid and its subsidiaries with a minimum retirement benefit. Under the pension plan a participant's retirement benefit is computed using formulas based on percentages of highest average compensation computed over five consecutive years. The compensation covered by the pension plan includes salary, bonus and incentive share awards. Supplemental nonqualified, non-contributory executive retirement programs provide additional defined pension benefits for certain executives.

The Company provides health care and life insurance coverage to eligible retired employees. Eligibility is based on certain age and length of service requirements and in some cases retirees must contribute to the cost of their coverage.

Funding Policy. Absent unusual circumstances, the Company's funding policy is to contribute each year the maximum tax-deductible amount for that year. However, the contribution for any year will not be less than the minimum contribution required by federal law or greater than the maximum tax-deductible amount.

Investment Strategy. The Company manages its pension and postretirement benefit plans' investments to minimize the long-term cost of operating the plan, with a reasonable level of risk. Risk tolerance is determined as a result of a periodic asset/liability study which analyzes plan liabilities and plan funded status and results in the determination of the allocation of assets across equity and fixed income. Equity investments are broadly diversified across U.S. and non-U.S. stocks, as well as across growth, value, and small and large capitalization stocks. Likewise, the fixed income portfolio is broadly diversified across the various fixed income market segments. Small investments are also held in private equity, real estate and timber, with the objective of enhancing long-term returns while improving portfolio diversification. Investment risk and return is reviewed by an investment committee on a quarterly basis.

The target asset allocation for the pension plan is:

Year ended March 31,	**2004**	2003
U.S. Equities	**42%**	50%
Global Equities (including U.S.)	**7%**	-
Non-U.S. Equities	**11%**	15%
Fixed Income	**35%**	35%
Private Equity and Property	**5%**	-
Total	**100%**	100%

The target asset allocation for the postretirement benefit plan is:

Year ended March 31,	**2004**	2003
U.S. Equities	**45%**	45%
Non-U.S. Equities	**15%**	15%
Fixed Income	**40%**	40%
Total	**100%**	100%

Expected Rate of Return on Assets. The estimated rate of return for various passive asset classes is based both on analysis of historical rates of return and forward looking analysis of risk premiums and yields. Current market conditions, such as inflation and interest rates, are evaluated in connection with the setting of our long-term assumption. A small premium is added for active management of both equity and fixed income. The rates of return for each asset class are then weighted in accordance with our target asset allocation, and the resulting long-term return on asset rate is then applied to the market-related value of assets.

The benefit plans' costs used the following assumptions:

Pension Benefits

For the year ended March 31,	**2004**	2003
Weighted average assumptions used to determine net periodic cost:		
Discount rate	**6.25%**	7.50%
Rate of compensation increase		
Union	**4.00%**	4.00%
Non-Union	**5.25%**	5.25%
Expected return on plan assets	**8.50%**	8.75%

Other Postretirement Benefits

For the year ended March 31,	**2004**	2003
Weighted average assumptions used to determine net periodic cost:		
Discount rate	**6.25%**	7.50%
Expected return on plan assets		
Union	**8.75%**	9.00%
Non-Union	**7.25%**	7.50%
Medical trend		
Initial	**10.00%**	10.00%
Ultimate	**5.00%**	5.00%
Year ultimate rate reached	**2008**	2007

The Company's pension cost for the years ended March 31, 2004 and 2003 included the following components:

(In thousands)	Year Ended March 31, 2004	2003
Service cost – benefits earned during the period	**$ 7,571**	$ 5,552
Plus (less):		
Interest cost on projected benefit obligation	**24,779**	24,482
Return on plan assets at expected long-term rate	**(30,678)**	(34,746)
Amortization of prior service cost	**573**	584
Amortization of net loss	**8,841**	3
Curtailment loss	**417**	-
Net pension cost (income)	**$ 11,503**	$ (4,125)
Special termination benefits	**$ 31,037**	$ -

The Company's total cost of postretirement benefits other than pensions (PBOPs) for the years ended March 31, 2004 and 2003 included the following components:

(In thousands)	Year Ended March 31, 2004	2003
Service cost - benefits earned during the period	**$ 3,857**	$ 2,959
Plus (less):		
Interest cost on projected benefit obligation	**16,249**	15,426
Return on plan assets at expected long-term rate	**(10,696)**	(10,757)
Amortization of prior service cost	**(339)**	(58)
Amortization of net loss	**5,308**	1,663
Curtailment loss	**5,974**	-
Postretirement benefit cost	**$ 20,353**	$ 9,233
Special termination benefits	**$ 3,706**	$ -

The funded status of the pension plan cannot be presented separately for the Company as the Company participates in the plan with certain other National Grid subsidiaries.

The following table provides the changes in the National Grid companies' pension plan's fair value of assets for the fiscal years ended March 31, 2004 and 2003, and the percentage distribution of the fair market value of the types of assets held in the pension plan's trust. The expected contribution to the National Grid companies' pension plan during fiscal 2005 is approximately $50 million.

(In millions)	Year Ended March 31, 2004	2003
Reconciliation of change in plan assets:		
Fair value of plan assets at beginning of period	**$ 869**	$ 1,053
Actual return (loss) on plan assets during year	**256**	(110)
Company contributions	**75**	8
Benefits paid from plan assets	**(98)**	(82)
Fair value of plan assets at end of period	**$ 1,102**	$ 869

	2004	2003
Distribution of plan assets:		
Debt securities	**34%**	39%
Equity securities	**63%**	58%
Property/real estate	**1%**	1%
Other	**2%**	2%
	100%	100%

The following table provides the changes in the Company's portion of the National Grid companies' postretirement plan's fair value of assets for the fiscal years ended March 31, 2004 and 2003, and the percentage distribution of the fair market value of the types of assets held in the postretirement plan's trust. The Company's expected contribution to the postretirement plan during fiscal 2005 is approximately $15 million.

(In millions)	2004	2003
Reconciliation of change in plan assets:		
Fair value of plan assets at beginning of period	**$ 101**	$ 112
Actual return on plan assets during year	**27**	(12)
Company contributions	**14**	11
Benefits paid from plan assets	**(12)**	(10)
Fair value of plan assets at end of period	**$ 130**	$ 101

Year ended March 31,	2004	2003
Distribution of plan assets:		
Debt securities	**38%**	**55%**
Equity securities	**61%**	**44%**
Other	**1%**	**1%**
	100%	**100%**

Massachusetts Electric Company

Notes to Financial Statements

The following table provides a reconciliation of the changes in the National Grid companies' pension plan's benefit obligations, the accumulated benefit obligation and the assumptions used in developing those obligations for the National Grid companies' pension plan at March 31:

(In millions)	Year Ended March 31, **2004**	2003
Accumulated benefit obligation	**$ 1,249**	$ 1,125
Change in benefit obligation:		
Benefit obligation at beginning of period	**$ 1,258**	$ 1,074
Service cost	**20**	15
Interest cost	**78**	78
Actuarial loss	**93**	173
Benefits paid	**(98)**	(82)
Curtailments	**(4)**	-
Special termination benefits	**78**	-
Benefit obligation at end of period	**$ 1,425**	$ 1,258
Reconciliation of prepaid cost		
Fair value of plan assets at end of period	**$ 1,102**	$ 869
Funded status	**$ (323)**	$ (389)
Unrecognized actuarial loss	**543**	646
Unrecognized prior service cost	**14**	17
Net amount recognized	**$ 234**	$ 274
Amounts recognized on the balance sheet consist of:		
Accrued benefit liability	**$ (148)**	$ (255)
Intangible asset	**16**	18
Regulatory assets	**62**	92
Accumulated other comprehensive income	**304**	419
Net amount recognized	**$ 234**	$ 274

Year ended March 31	**2004**	2003
Assumptions used to determine pension benefit obligation:		
Discount rate	**5.75%**	6.25%
Average rate of increase in future compensation level		
Union	**4.00%**	4.00%
Non-Union	**5.25%**	5.25%
Expected long-term rate of return on assets	**8.50%**	8.50%

The following provides a reconciliation of the Company's postretirement benefit obligations and plan assets at March 31:

(In millions)	**2004**	2003
Change in benefit obligation:		
Benefit obligation at beginning of period	**$ 266**	$ 205
Service cost	**4**	3
Interest cost	**16**	15
Actuarial loss	**30**	53
Benefits paid	**(12)**	(10)
Special termination benefits	**4**	-
Curtailment loss	**6**	-
Plan amendments	**(4)**	-
Benefit obligation at end of period	**$ 310**	$ 266
Reconciliation of accrued cost:		
Fair value of plan assets at end of period	**$ 130**	$ 101
Funded status	**(180)**	(165)
Unrecognized actuarial	**139**	131
Unrecognized prior service benefit	**(4)**	-
Unrecognized transition asset	**-**	(1)
Net amount accrued	**$ (45)**	$ (35)

Year ended March 31,	**2004**	2003
Weighted average assumptions to determine postretirement benefit obligation:		
Discount rate	**5.75%**	6.25%
Expected long-term rate of return on assets		
Union	**9.50%**	8.75%
Non-Union	**5.75%**	7.25%
Medical Trend		
Initial	**10.00%**	10.00%
Ultimate	**5.00%**	5.00%
Year ultimate reached	**2009**	2008

The assumptions used in the health care cost trends have a significant effect on the amounts reported. A one percentage point change in the assumed rates would increase the accumulated postretirement benefit obligation (APBO) as of March 31, 2004 by approximately $41.6 million or decrease the APBO by approximately $36.6 million, and increase or decrease the net postretirement cost for 2004 by approximately $3 million.

2. Additional Minimum Liability (AML): SFAS No. 87 "Employers' Accounting for Pensions" states that if a pension plans' ABO exceeds the fair value of plan assets, the employer shall recognize in the statement of financial position a liability that is at least equal to the unfunded ABO with an offsetting charge to other comprehensive income. Due to the severe downturn in the capital markets the Company's ABO at March 31, 2004 and 2003 is greater than the fair value of plan assets. If in the future, capital markets recover such that the fair value of plan assets is once again greater than the ABO, the additional minimum pension liability will be removed from the Company's balance sheets. As such, at March 31, 2004 and 2003, the Company has recognized an additional minimum pension liability of $132 million and $181 million, respectively, on its balance sheet reflecting the under funded pension obligation. (See Note K)

The Company has also recognized an allocated share of additional minimum pension liability of its affiliated service company of $48 million at years ended March 31, 2004 and 2003 which is recorded in accounts payable on the balance sheet with an offsetting charge to other comprehensive income.

3. Voluntary Early Retirement:
In January 2002, the Company offered a voluntary early retirement program to non-union employees who met certain eligibility requirements. Eligible employees were in targeted functions and will be age 55 with at least ten years of pension service by March 31, 2004. The program is intended to reduce the National Grid USA workforce through voluntary means.

In fiscal year 2003, National Grid companies made voluntary early retirement offers (VEROs). The VEROs were made to eligible both union and non-union employees with a total of 717 employees accepting the VERO offerings. The majority of them will retire by November 1, 2004, with the remainder retiring no later than January 1, 2008.

The Company's total VERO expense for union and non-union employees in fiscal year 2004 was approximately $61.1 million which is included in "Other operation" in the accompanying Statement of Income.

Note E - Income Taxes

The Company and other subsidiaries participate with National Grid General Partnership, a wholly owned subsidiary of National Grid Transco plc, in filing consolidated federal income tax returns. The Company's income tax provision is calculated on a separate return basis. Federal income tax returns have been examined and reported on by the Internal Revenue Service through 1996.

Total income taxes in the statements of income are as follows:

Year ended March 31,(In thousands)	**2004**	2003
Income taxes charged to operations	**$ 23,942**	$ 52,873
Income taxes credited to "Other income"	**(424)**	(1,119)
Total income taxes	**$ 23,518**	$ 51,754

Total income taxes, as shown above, consist of the following components:

Year ended March 31,(In thousands)	**2004**	2003
Current income taxes	**$ 599**	$ 42,799
Deferred income taxes	**24,203**	10,254
Investment tax credits, net	**(1,284)**	(1,299)
Total income taxes	**$ 23,518**	$ 51,754

Investment tax credits have been deferred and are being amortized over the estimated lives of the property giving rise to the credits.
Total income taxes, as shown above, consist of federal and state components as follows:

Year ended March 31,(In thousands)	**2004**	2003
Federal income taxes	**$ 18,876**	$ 41,476
State income taxes	**4,642**	10,278
Total income taxes	**$ 23,518**	$ 51,754

Consistent with rate-making policies of the MDTE, the Company has adopted comprehensive inter-period tax allocation (normalization) for temporary book/tax differences.

Total income taxes differ from the amounts computed by applying the federal statutory tax rates to income before taxes. The reasons for the differences are as follows:

Year Ended March 31, (In thousands)	**2004**	2003
Computed tax at statutory rate	**$ 20,397**	$ 45,371
Increases (reductions) in tax resulting from:		
Amortization of investment tax credits	**(1,284)**	(1,299)
State income tax, net of federal income tax benefit	**3,017**	6,681
Excess deferred tax adjustment	**-**	748
All other differences	**1,388**	253
Total income taxes	**$ 23,518**	$ 51,754

The Company applies the provisions of SFAS No. 109, "Accounting for Income Taxes", which requires recognition of deferred income taxes for temporary differences that are reported in different years for financial reporting and tax purposes using the liability method. Under the liability method, deferred tax liabilities or assets are computed using the tax rates that will be in effect when temporary differences reverse. Generally, for regulated companies, the change in tax rates may not be immediately recognized in operating results because of rate-making treatment and provisions in the Tax Reform Act of 1986.

The following table identifies the major components of total deferred income taxes:

At March 31, (In millions)	**2004**	2003
Deferred tax asset:		
Plant related	**$ 30**	$ 25
Investment tax credits	**4**	5
All other	**90**	118
Total deferred tax asset:	**124**	148
Deferred tax liability:		
Plant related	**(302)**	(284)
Total deferred tax liability:	**(302)**	(284)
Net deferred tax liability	**$ (178)**	$ (136)

There were no valuation allowances for deferred tax assets deemed necessary at March 31, 2004 and March 31, 2003, respectively.

Massachusetts Electric Company

Notes to Financial Statements

Note F - Short-term Borrowings and Other Accrued Expenses

At March 31, 2004 and 2003, the Company had approximately $221 million and $133 million, respectively, of short-term debt outstanding to affiliates. The Company has regulatory approval from the Securities and Exchange Commission, under the Public Utility Holding Company Act of 1935 (1935 Act), to issue up to $275 million of short-term debt. National Grid and certain subsidiaries, including the Company, with regulatory approval, operate a money pool to more effectively utilize cash resources and to reduce outside short-term borrowings. Short-term borrowing needs are met first by available funds of the money pool participants. Borrowing companies pay interest at a rate designed to approximate the cost of outside short-term borrowings. Companies that invest in the pool share the interest earned on a basis proportionate to their average monthly investment in the money pool. Funds may be withdrawn from or repaid to the pool at any time without prior notice.

The components of other accrued expenses are as follows:

At March 31, (In thousands)	**2004**	2003
Rate adjustment mechanisms	**$ 10,201**	$ 19,625
Accrued wages and benefits	**18,442**	15,141
Other	**6,251**	3,272
Total other accrued expenses	**$ 34,894**	$ 38,038

Note G - Cumulative Preferred Stock

A summary of cumulative preferred stock at March 31, 2004 and 2003 is as follows (in thousands except for share data):

	Shares Outstanding		Amount		Dividends Declared		Call Price
	2004	2003	**2004**	2003	**2004**	2003	
$100 par value-							
4.440% Series	**22,585**	22,585	**$2,259**	$ 2,259	$100	$100	$104.068
4.760% Series	**24,680**	25,130	**2,468**	2,468	117	120	103.730
6.990% Series	**-**	54,000	**-**	5,400	95	377	(a)
Total	**47,265**	101,715	**$4,727**	$10,127	$312	$597	

(a) Called on August 1, 2003 at $103.50.

The annual dividend requirement for cumulative preferred stock was approximately $312,000 and $597,000 for the years ended March 31, 2004 and 2003, respectively.

Massachusetts Electric Company

Notes to Financial Statements

Note H - Long-term Debt

A summary of long-term debt is as follows:

At March 31 (In thousands)

Series	Rate %	Maturity	**2004**	2003
First Mortgage Bonds:				
T(93-5)	6.400	June 24, 2003		$ 10,000
U(93-1)	6.240	November 17, 2003		5,000
U(94-6)	8.520	November 30, 2004	**$ 10,000**	10,000
U(95-1)	8.450	January 10, 2005	**10,000**	10,000
U(95-2)	8.220	January 24, 2005	**10,000**	10,000
U(95-7)	7.920	March 3, 2005	**9,000**	9,000
V(95-1)	6.720	June 23, 2005	**10,000**	10,000
V(96-1)	6.780	November 20, 2006	**20,000**	20,000
T(93-7)	6.660	June 23, 2008	**5,000**	5,000
T(93-8)	6.660	June 30, 2008	**5,000**	5,000
T(93-10)	6.110	September 8, 2008	**10,000**	10,000
T(93-11)	6.375	November 17, 2008	**10,000**	10,000
V(98-3)	5.720	November 24, 2008	**25,000**	25,000
T(93-6)	7.500	June 23, 2023	**-**	3,000
T(93-9)	7.500	June 29, 2023	**-**	7,000
U(93-2)	7.200	November 15, 2023	**-**	10,000
U(93-3)	7.150	November 24, 2023	**-**	1,000
U(94-1)	7.050	February 2, 2024	**-**	10,000
U(94-2)	8.080	May 2, 2024	**5,000**	5,000
U(94-3)	8.030	June 14, 2024	**5,000**	5,000
U(94-4)	8.160	August 9, 2024	**5,000**	5,000
U(94-5)	8.850	November 7, 2024	**1,000**	1,000
U(95-6)	8.460	February 28, 2025	**3,000**	3,000
V(95-2)	7.630	June 27, 2025	**10,000**	10,000
V(95-3)	7.600	September 12, 2025	**10,000**	10,000
V(95-4)	7.630	September 12, 2025	**10,000**	10,000
V(97-1)	7.390	October 1, 2027	**15,000**	15,000
V(98-1)	6.910	January 12, 2028	**20,000**	20,000
V(98-2)	6.940	January 12, 2028	**5,000**	5,000
Pollution Control Revenue Bonds:				
1993	5.875	August 1, 2008	**40,000**	40,000
Unamortized discounts			**(791)**	(940)
Total long-term debt			**$252,209**	$298,060
Long-term debt due within one year			**39,000**	15,000
Total long-term debt, excluding current portion			**$213,209**	$ 283,060

Substantially all of the properties and franchises of the Company are subject to the lien of mortgage indentures under which the first mortgage bonds have been issued.

The Company is scheduled to make cash payments of approximately $39 million in fiscal year 2005, approximately $10 million in fiscal year 2006, approximately $20 million in fiscal year 2007, $0 in fiscal year 2008, $95 million in fiscal year 2009, and $89 million thereafter, to retire maturing bonds.

At March 31, 2004 and 2003, the Company’s long-term debt had a carrying value of $253 million and $298 million and had a fair value of approximately $277 million and $325 million, respectively. The fair market value of the Company's long-term debt was estimated based on the quoted prices for similar issues or on the current rates offered to the Company for debt of the same remaining maturity.

Note I - Restrictions on Retained Earnings Available for Dividends on Common Stock

As long as any preferred stock is outstanding, certain restrictions on payment of dividends on common stock would come into effect if the "junior stock equity" as defined by the preferred stock agreement was, or by reason of payment of such dividends became, less than 25 percent of "Total capitalization". However, the junior stock equity at March 31, 2004 was 87 percent of total capitalization and, accordingly, none of the Company's retained earnings at March 31, 2004 were restricted as to dividends on common stock under the foregoing provisions.

Note J - Supplementary Income Statement Information

Advertising expenses, expenditures for research and development, and rents were not material and there were no royalties paid in 2004 or 2003. Taxes, other than income taxes, charged to operating expenses are set forth by class as follows:

Year ended March 31,(In thousands)	**2004**	2003
Municipal property taxes	**$ 28,107**	$ 28,997
Federal and state payroll and other taxes	**9,976**	10,092
Total taxes, other than income taxes	**$ 38,083**	$ 39,089

National Grid USA Service Company, Inc., an affiliated service company operating pursuant to the provisions of Section 13 of the 1935 Act, furnished services to the Company at the cost of such services. These costs amounted to $165.4 million and $123.4 million, including capitalized construction costs of $18.7 million and $12.9 million, for the years ended March 31, 2004 and 2003, respectively.

Note K – Accumulated Other Comprehensive Income (Loss)

(In Thousands)	Unrealized Gain (Loss) on Available-for-Sale Securities	Minimum Pension Liability Adjustment	Total Accumulated Other Comprehensive (Loss)
March 31, 2002	$ 42	$ -	$ 42
Other comprehensive income (loss):			
Unrealized gains (losses) on securities, net of taxes	(98)	-	(98)
Change in minimum pension liability, net of taxes	-	(152,728)	(152,728)
March 31, 2003	$ (56)	$ (152,728)	$ (152,784)
Other comprehensive income (loss):			
Unrealized gains (losses) on securities, net of taxes	243	-	243
Change in minimum pension liability, net of taxes	-	28,876	28,876
March 31, 2004	$ 187	$ (123,852)	$ (123,665)

NANTUCKET ELECTRIC COMPANY
Source and Application of Funds
(In Millions)

		Actual	Estimated				Total
	Fiscal Year Ending March 31	**2004**	**2005**	**2006**	**2007**	**2008**	**FY05-08**
	Sources of Funds						
	Internal:						
1	Internally Generated Funds	$ 2.7	$ 3.5	$ 2.5	$ 3.1	$ 3.3	$ 12.4
2	Capital Contributions from Parent	-					-
3	Short-Term Debt	1.7	3.3	(1.9)	0.5	(4.0)	(2.0)
4	Total Internal Funds	$ 4.5	$ 6.7	$ 0.6	$ 3.6	$ (0.7)	$ 10.4
	External:						
5	Long-Term Debt	$ -	$ 12.8	$ 25.0	$ 16.1	$ 4.0	$ 57.9
6	Total External Funds	$ -	$ 12.8	$ 25.0	$ 16.1	$ 4.0	$ 57.9
7	**Total Sources**	$ 4.5	$ 19.5	$ 25.6	$ 19.7	$ 3.3	$ 68.2
	Application of Funds						
	Capital Requirements:						
8	Plant and Equipment	$ 2.7	$ 15.2	$ 23.2	$ 0.3		$ 38.7
9	Retirement of Debt	$ 1.5	$ 4.3	$ 2.4	$ 19.4	$ 3.3	29.5
10	**Total Capital Requirements**	$ 4.2	$ 19.5	$ 25.6	$ 19.7	$ 3.3	$ 68.2
11	**Short-Term Debt Balance at End of Year**	$ 2.6	$ 5.8	$ 4.0	$ 4.5	$ 0.5	
	Capitalization Data						
	Amount:						
12	Long-Term Debt	$ 21.6	$ 30.0	$ 52.6	$ 49.3	$ 49.9	
13	Short-Term Debt	$ 2.6	$ 5.8	$ 4.0	$ 4.5	$ 0.5	
14	Common Equity	$ 23.9	$ 24.2	$ 24.6	$ 24.1	$ 23.6	
15	Total Capitalization	$ 48.0	$ 60.1	$ 81.2	$ 77.9	$ 74.0	
	Ratios:						
16	Long-Term Debt	45.0%	50.0%	64.8%	63.3%	67.5%	
17	Short-Term Debt	5.3%	9.7%	4.9%	5.7%	0.7%	
18	Common Equity	49.7%	40.3%	30.3%	31.0%	31.9%	
19	Total	100.0%	100.0%	100.0%	100.0%	100.0%	

NANTUCKET ELECTRIC COMPANY
Comparison of Net Utility Plant to Total Capitalization
March 31, 2004 (In thousands)
(Audited)

		Actual (a)	Adjustments (b)	Proforma (c)
	Assets			
1	**Utility plant, at original cost**	$ 49,989	37,000	$ 86,989
2	Less accumulated provisions for depreciation	17,812		17,812
3		32,177	37,000	69,177
4	Construction work in progress	3,002	(3,054)	(52)
5	Net utility plant	35,179	33,946	69,125
6	Goodwill	15,679	(15,679)	-
7	Pension intangible	50		50
8	**Current assets:**			
9	Cash and cash equivalents	412	1,054	1,466
10	Accounts receivable:			
11	From electric energy services, including unbilled revenues	4,427		4,427
12	Other (including $1,121 from affiliates)	1,126		1,126
13	Less reserves for doubtful accounts	29		29
14		5,524		5,524
15	Materials and supplies, at average cost	192		192
16	Prepaid and other current assets	7		7
17	Total current assets	6,135	1,054	7,189
18	Regulatory assets	-		-
19	Deferred charges and other assets	2,143		2,143
20	Total assets	$ 59,186	19,321	$ 78,507
	Capitalization and Liabilities			
	Capitalization:			
21	Common stock, par value $1 per share,			
22	authorized and outstanding 1 share	$ -		$ -
23	Other paid-in capital	22,481	(15,679)	6,802
24	Retained earnings	2,535		2,535
25	Accumulated other comprehensive income (loss)	(1,158)		(1,158)
26	Total common equity	23,858	(15,679)	8,179
27	Cumulative preferred stock	-		-
28	Long-term debt	20,055	33,250	53,305
29	Total capitalization	43,913	17,571	61,484
	Current liabilities:			
30	Long-term debt due within one year	1,535	1,750	3,285
31	Short-term debt to affiliates	2,550		2,550
32	Accounts payable (including $104 to affiliates)	1,620		1,620
33	Accrued liabilities:			
34	Taxes	249		249
35	Deferred federal and sate income taxes	86		86
36	Interest	309		309
37	Other accrued expenses	3,213		3,213
38	Customer deposits	22		22
39	Dividends payable	-		-
40	Total current liabilities	9,584	1,750	11,334
41	Deferred federal and state income taxes	2,513		2,513
42	Unamortized investment tax credits	63		63
43	Accrued pension and other post-retirement benefits	1,211		1,211
44	Additional minimum pension liability	1,233		1,233
45	Other reserves and deferred credits	669		669
46	Commitments and contingencies	-		-
47	Total capitalization and liabilities	$ 59,186	19,321	$ 78,507

Comparison of Net Utility Plant and Capitalization

Net Utility Plant including Proposed Project (line 5c)	69,125
Total Capitalization less Incremental debt in Total Capitalization due to Proposed Financing (line 29c less line 28b)	28,234
Incremental debt due to Proposed Financing (lines 28b and 30b)	35,000
Excess of Net Utility Plant over Total Capitalization	5,891